Supreme Court, U.S.
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

HERCULES INCORPORATED,
Petitioner,

v.

UTAH STATE TAX COMMISSION AUDITING DIVISION,
Respondent.

Petition for a Writ of Certiorari to the Supreme Court of the State of Utah

---

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a state violates the Commerce Clause when, contrary to the decisions of this Court and based on differing interpretations of the same uniform act, it apportions and taxes the same income already taxed by another state, claiming that it has done so "properly," while pointing to the other state as having "improperly" imposed the double tax.

DISCLOSURE STATEMENT PURSUANT TO RULE 29.1

Hercules Incorporated has no parent company.

Abieta Chemie GmbH;
Algas Marinas, S.A.;
Aqualon Company;
BHC Laboratories, Inc.;
Genu Products Phillippines;
Hercofina Joint Venture;
Hercules Korea Chemical Company Limited;
Hercules-Sanyo, Inc.;
Hispan Corporation;
Inversiones Alpha S.A.;
Pakistan Gum Industries Limited;
Pesquera Punta Rioles Limited;
Polo Industria e Commercio Limited;
Quimproc S.A. de C.V.;
Rika-Hercules Incorporated;
St. Croix Petrochemical Corp.;
Sumika-Hercules Company Ltd.;
Taema S.p.A.;
Taiwan Hercules Chemicals, Inc.;
Taloquimia S.A. de C.V.;
Tastemaker; and
Tastemaker, BV

are subsidiaries of Hercules Incorporated that are not wholly owned.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Hercules Incorporated hereby petitions for a writ of certiorari to review the judgment of the Supreme Court of the State of Utah in this case.

OPINIONS BELOW

The opinion of the Utah Supreme Court is reported at 877 P.2d 133 (Utah 1994) and is included in the Appendix at 1a-9a. The Utah Court of Appeals' opinion is reported at 845 P.2d 941 (Utah App. 1992) and is included in the Appendix at 10a-16a. The Memorandum Decision of the Third Judicial District Court for Salt Lake County, Tax Division, is not reported and is included in the Appendix at 17a-27a. The Findings of Fact, Conclusions of Law and Final Decision of the Utah State Tax Commission is not reported and is included in the Appendix at 28a-33a.

JURISDICTION

The decision of the Utah Supreme Court in this matter was entered on June 10, 1994. On August 23, 1994, Justice Ginsburg granted an extension of time to and including October 10, 1994, within which to file a petition for a writ of certiorari. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The United States Constitution provides, in pertinent part:

> The Congress shall have Power . . . To regulate Commerce . . . among the several States . . . .

U.S. Const. art. I, § 8, cl. 3.

The United States Constitution also provides, in pertinent part:

> This Constitution . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any state to the Contrary notwithstanding.

U.S. Const. art. VI, cl. 2.

STATEMENT

1. *Hercules's Aerospace Business*

Petitioner, Hercules Incorporated ("Hercules"), is a Delaware corporation whose wide variety of business pursuits includes aerospace manufacturing. Hercules operates eleven production facilities for this type of work throughout the United States, including one in Bacchus, Utah. The Bacchus Works are involved exclusively in the design and manufacture of strategic missiles. The Bacchus Works have produced such missiles as the Delta, the Titan, and the Pershing. The work carried out at Bacchus is a sensitive matter of national security.

During the tax years at issue in this dispute, 1977 to 1980, the United States contracted with Lockheed Missiles & Space Co. ("Lockheed") to furnish Trident nuclear missiles to the United States Navy for installation on its submarines. App. 34a. Lockheed, in turn, subcontracted with Hercules to furnish Lockheed with a three-stage rocket motor for the missiles. *Id.* The missile motors consisted principally of unignited explosive propellant. Under Lockheed's supervision, and in coordination with Lockheed, Hercules constructed the motors at its facility in Bacchus to predetermined specifications. R. 1106, 1147.* At this point in the manufacturing process, however, the rocket motors were not functional. R. 1098.

Legal title to the rocket motors passed from Hercules to Lockheed, and from Lockheed to the United States at the Bacchus facility. R. 1092. Hercules then shipped the motors from Utah, via common carrier, to another manufacturing/assembling facility at military seaports in the states of Washington and California. R. 1093, 1109. There, under Hercules's supervision and inspection, Lockheed joined the rocket motor stages together, interfaced the motor stages with other motor components, and assembled the completed missile. R. 1128. Hercules's responsibilities at the seaport sites included the design of the buildings, facilities, and equipment used in the assembly of the missiles, the training of Lockheed and government personnel, and the supply of parts, tools, and equipment. R. 1128-33. Hercules was referred to as the "motor mother." R. 1132. Once assembly had been completed, the missiles were physically turned over to the United States Navy for arming and deployment. R. 1126-31. The entire manufacturing process, from fabrication of each rocket motor stage to the completion of the missile, lasted approximately seven months, starting at Hercules's Utah facility, and ending in either Washington or California. R. 1147. While the parties dispute where the missile motors were ultimately "manufactured," the essential fact

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* "R. ——" refers to the record before the Utah Supreme Court.

that the motors Hercules sold to Lockheed were transported across state lines for further assembly and interfacing with other missile components, as part of a multistate enterprise, has never been disputed.

2. *Double Taxation of Hercules*

During 1977 to 1980, the State of California charged Hercules a franchise tax. Since 1967, California has used the Uniform Division of Income for Tax Purposes Act ("UDITPA") established by the Multistate Tax Compact for apportioning the income of interstate corporations for state tax purposes.[1] UDITPA utilizes a formula based on three factors that measure the activities by which value is generated in order to determine the portion of income that is subject to state income tax. These factors are payroll, property, and sales. In-state amounts for each of these factors are divided by total interstate figures to determine the proportion of each factor that is attributable to the state. These fractions are then averaged to determine the percentage of income subject to state taxation. The averaging of three distinct measurements of the generation of value is intended to estimate more accurately the proper division of interstate income between states. The payroll and property factors emphasize the activity of manufacturing states, while sales, which are attributed to the states to which goods are shipped, estimate the contribution of market states. See generally William J. Pierce, *The Uniform Division of Income for State Tax Purposes,* 35 Taxes 747, 780 (1957).

It is uncontested that the State of California treated the sales of motors for the missiles assembled in California as California sales and included those sales in its apportionment of interstate income, thereby taxing Hercules on 100% of the income derived from those sales.

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[1] *See* Cal. Rev. & Tax Code §§ 25120-25141 (West Supp. 1994) for current codification. While the Multistate Tax Compact has not been adopted by Congress, this Court has upheld its constitutionality, *see United States Steel Corp.* v. *Multistate Tax Comm'n,* 434 U.S. 452 (1978).

App. 35a. Likewise, it is uncontested that during these years, Washington, which also had adopted the Multistate Tax Compact's UDITPA,[2] determined that final delivery of the motors for the missiles assembled in Washington did not occur until the rocket motors were installed in Washington. The State of Washington therefore taxed Hercules on 100% of the income derived from those sales under its Business and Occupation tax. *Id.* Hercules did not pay income tax to Utah on the income derived from the rocket motor sales during these years and had no reason to dispute the California and Washington tax assessments. California and Washington, as market (or "destination") states, were plainly entitled to tax the sales income under UDIPTA.[3]

However, in August 1982, five years after Hercules began supplying the rocket motors to Lockheed, the Utah State Tax Commission ("tax commission"), respondent, issued a notice of deficiency to Hercules. Notwithstanding the fact that Utah also had adopted the UDITPA three-factor-based apportionment system,[4] the tax commission decided that Hercules should pay Utah income tax on the rocket motor sales that had taken place in 1977 through 1980. The tax commission concluded that the rocket motor sales had not been interstate sales, but rather were "Utah sales," and thus includable in their entirety as in-state sales in the sales apportionment factor. Thus, two states each subjected the same transactions to their state's income tax. Hercules promptly petitioned for a redetermination and in 1987 the tax commission held a formal hearing.

On October 4, 1988, the tax commission affirmed its finding of a deficiency against Hercules and ruled that the rocket motor sales at issue were Utah sales, even though

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[2] *See* Wash. Rev. Code § 82.56.010 (1994) for current codification.

[3] To be sure, Utah afforded Hercules various services and protections. Hercules is subject to other assessments in Utah, such as sales and property taxes.

[4] *See* Utah Code Ann. §§ 59-7-301 to 321 (1992) for current codification.

they had already been fully taxed in Washington and California in accordance with those states' prior determinations. App. 33a. In order to appeal the tax commission's ruling to a Utah district court, Hercules, under protest, paid $456,512.00 in contested taxes and interest. R. 13.

3. *Lower Court Proceedings*

A *de novo* trial was held before the Utah District Court for Salt Lake County, subject to the joint stipulation of facts by the parties. See App. 34a-36a. The district court reversed the tax commission, finding that the rocket motor sales were not sales subject to Utah's income tax. App. 26a. The district court determined that the rocket motors, the subject of the sales, were not completed until they were integrated into missiles located in either California or Washington and that the sales therefore were not attributable to Utah. *Id.* In addition, the district court held that the Commerce Clause of the United States Constitution limited Utah's ability to tax revenue generated by interstate activity. App. 27a. The court found that Hercules's sales of rocket motors were interstate sales and that Utah had violated the Commerce Clause by subjecting Hercules to double taxation. *Id.*

The tax commission appealed the district court's decision and the Utah Court of Appeals reversed. App. 16a. Although the court of appeals conceded that the rocket motors were not functional or even capable of being ignited when they left Hercules's Utah facility, App. 14a, it found that the rocket motor transactions had been completed within Utah. App. 15a-16a. Moreover, the court of appeals concluded, the transactions did not involve interstate commerce and therefore the court did not even have to consider Hercules's claim that Utah's taxation of these sales violated the Commerce Clause. *Id.*

4. *Utah Supreme Court Opinion*

The Utah Supreme Court granted Hercules's petition for certiorari and on June 10, 1994, affirmed the court of

appeals. App. 9a. The Utah Supreme Court agreed with the court of appeals that the rocket motor transactions were not interstate sales. *Id.* The Utah Supreme Court dismissed the substantial work that had occurred in California and Washington during the completion and installation of the rocket motors and the assembly of the missiles as nothing more than a "warranty" for the work that had already taken place in Utah. App. 6a. In total disregard of our system of cooperative federalism, the Utah Supreme Court held that what subsequently occurred to the rocket motors after they left Utah "d[id] not affect the local nature of the sales transactions." App. 9a. It concluded that Utah was free to allocate the *entire* rocket motor sale to itself for purposes of income taxation. The court squarely acknowledged that Hercules had been taxed twice. Nevertheless, it disclaimed any responsibility, asserting that Utah could not have violated the Commerce Clause because it had taxed a transaction "occurring solely within this state." *Id.*

REASONS FOR GRANTING THE PETITION

The decision of the Utah Supreme Court raises a significant constitutional question under the Commerce Clause with respect to the multistate apportionment of the same income generated in interstate commerce. In this case, double taxation of the same income by several states is not hypothetical. It is real; it has in fact occurred. The burden that this double taxation places on interstate commerce and federal interests could not be clearer. The cost of providing the national defense, borne by all states, has been significantly inflated by the actions of one state. The approach taken by the Utah Supreme Court, artificially isolating into intrastate commerce transactions that are inherently interstate in nature, is an unacceptable manner of protecting the integrity of interstate commerce and the federal interest in the zone of trade among the states.

The decision below independently warrants review by this Court because Utah has necessarily, though implicitly, taken the position that it is California and Washington whose taxation violates the Commerce Clause. We do not agree because those are the destination states. But the more important—and undisputed—fact for purposes of this petition is that two separate states have taxed 100% of the income generated by the same interstate sales. Neither is willing to yield, and *only* this Court can resolve the controversy surrounding multistate taxation of the same income. As demonstrated by the decision below, individual state courts have little incentive to deny their tax officials the funds available for state coffers through the disproportionate taxation of interstate income. Even if double taxation is conceded, the second state can merely blame the first for improperly taxing the interstate commerce. That is precisely what has happened here. The proper apportionment of income from interstate commerce for state taxation is a matter of profound economic importance for all industry and commerce that operates across state lines.

THE DECISION BELOW CONFLICTS WITH THIS COURT'S PRECEDENTS REGARDING THE COMMERCE CLAUSE AND RESULTS IN THE DOUBLE TAXATION OF HERCULES.

A.

This Court has "steadfastly adhered to the central tenet that the Commerce Clause 'by its own force created an area of trade free from interference by the States.'" *American Trucking Ass'ns* v. *Scheiner*, 483 U.S. 266, 280 (1987) (quoting *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318, 328 (1977)). In conformity with this constitutional command, this Court has stated that "[a]s a general principle, a State may not tax value earned outside its borders." *ASARCO, Inc.* v. *Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982). In order to comply with this limitation in assessing income taxes on

a unitary interstate business, the state must tax only that portion of a business's total income that reflects the corporation's earnings within the jurisdiction. See *Goldberg* v. *Sweet*, 488 U.S. 252, 260-61 (1989).

Only last Term, this Court reaffirmed its prior holdings that a state income tax on interstate commerce "will not survive Commerce Clause scrutiny if the taxpayer demonstrates that the tax either (1) applies to an activity lacking a substantial nexus to the taxing State; (2) is not fairly apportioned; (3) discriminates against interstate commerce; or (4) is not fairly related to the services provided by the State." *Barclays Bank PLC v. Franchise Tax Board*, 114 S. Ct. 2268, 2276 (1994) (citing *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977)).[5]

B.

The approach adopted by the Utah Supreme Court in the decision below, finding that the Utah tax did not violate the Commerce Clause, is inconsistent with the proper application of this Court's decisions. The Utah Supreme Court equated *all* of this Court's pronouncements on the Commerce Clause with a simplistic determination of "whether Utah correctly allocated the motor sales to Utah for purposes of taxation." App. 8a-9a. The Utah Supreme Court had already artificially determined that the taxed transaction occurred entirely within the state by focusing exclusively on when title to the motors had changed hands (even though the motors themselves had not been transferred) and by disregarding the continuation of the manu-

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[5] Although Hercules did not challenge Utah's income tax under the Due Process Clause of the Fourteenth Amendment, this Court has held that "[t]he *Complete Auto* test, while responsive to Commerce Clause dictates, encompasses as well the due process requirement that there be 'a 'minimal connection' between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise.'" *Trinova Corp.* v. *Michigan Dep't of Treasury*, 498 U.S. 358, 373 (1991) (quoting *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 436-37 (1980)).

facturing process taking place in other states. As a result, the Utah Supreme Court summarily concluded that the Commerce Clause could not have been violated because Utah had not taxed an interstate transaction.

1. It is clear, however, that Utah's taxation of Hercules's income based on the rocket motor sales violates the Commerce Clause under both the second and third prongs of the test enunciated by this Court in *Complete Auto*. Utah did not fairly apportion the income derived from Hercules's rocket motor sales and therefore taxing those sales in their entirety violates the second prong of this Court's *Complete Auto* test. This Court has held that for a tax to be "fairly apportioned" it must be both internally and externally consistent. See *Goldberg* 488 U.S. at 261. The tax Utah imposed on the rocket motor sales is neither.

First, in order for a tax to be internally consistent, the tax "must be structured so that if every State were to impose an identical tax, no multiple taxation would result." *Id.* It is clear that if every state adopted Utah's approach to taxation and the UDITPA, multiple taxation would inevitably result. Under Utah's approach, every state through which the commerce of a multistate enterprise passes can divide the transaction into "stages." The taxing state can then claim exclusive entitlement to tax fully the stage occurring within its borders on the basis of its relationship with the transaction. However, because the income generated by the enterprise is not also neatly divided into the artificial "stages" created by the state, the state taxes the full amount of income that was generated by the interstate enterprise, notwithstanding the fact that the commercial activity that took place in the other states substantially contributed to the income generated by the transaction. As a consequence, if every other state used Utah's approach, those states merely having a nexus to the rocket motor sales could fully tax the income generated by that transaction, and multiple

taxation would inevitably result. As the decisions of this Court make clear, having a sufficient nexus to the transaction is a necessary but *not* a sufficient condition for imposing a tax on interstate commerce. See, *e.g.*, *Complete Auto*, 430 U.S. at 279. Therefore, Utah's tax is internally inconsistent.

Second, a state tax imposed on interstate commerce must also be externally consistent. In order for a tax to be externally consistent, the State must tax "only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg*, 488 U.S. at 262. Utah cannot simply ignore the contribution made in other states to the generation of income from the rocket motor sales. The manufacture and installation of rocket motors into missiles destined for use in United States Navy submarines is commerce of an undeniably interstate character. The passage of title from Hercules to Lockheed and the United States cannot realistically be viewed as the single decisive factor in characterizing the Hercules-Lockheed multistate enterprise. It is undisputed that the Hercules-Lockheed contract involved a process in which Hercules and Lockheed worked cooperatively over an approximately seven-month period in several states, and that substantial work on the rocket motors was performed at the California and Washington seaport sites as the motor stages were joined together and then interfaced with other motor components. The Hercules-Lockheed enterprise clearly did not terminate at the Utah state line.

As a result, before imposing a tax, Utah must take into account that it is not the only jurisdiction in which income was generated by the rocket motor sales:

> [T]he fact that the corporate enterprise is a unitary one, in the sense that the ultimate gain is derived from the entire business, does not mean that for the purpose of taxation the activities which are conducted

> in different jurisdictions are to be regarded as 'component parts of a single unit' so that the entire net income may be taxed in one State regardless of the extent to which it may be derived from the conduct of the enterprise in another state.

Hans Rees' Sons, Inc. v. *North Carolina*, 283 U.S. 123, 133 (1931) (internal citations omitted). Because the rocket motor sales "reflect[] income from a unitary business, part of which is conducted in other States," "the income bears relation to benefits and privileges conferred by several States." *Exxon Corp.* v. *Wisconsin Dep't of Revenue*, 447 U.S. 207, 229 (1980). Therefore, "there is no reason" why the power to tax that income should be "exclusive" to Utah. *Id.* Despite this Court's instruction with respect to the limitations on state taxation imposed by the Commerce Clause, Utah refused to apportion *any* of the income derived from the rocket motor sales, much less apportion it *fairly*. Utah's tax is therefore externally inconsistent.

In sum, by recharacterizing the inquires this Court has deemed necessary in order to determine if a state income tax can prevail against a Commerce Clause challenge, the Utah Supreme Court effectively bypassed serious consideration of the constitutional questions posed by this taxing scheme. As the Utah Supreme Court noted, if only in passing, a state tax is not fairly apportioned if "the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State,' [*Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123, 135,] or has 'led to a grossly distorted result' [*Norfolk & W. Ry.* v. *State Tax Comm'n*, 390 U.S. 317, 326]. *Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267, 274 (1978)." See App. 8a. The Utah Supreme Court's analysis of the apportionment issue, however, is inconsistent with this standard.

In *Hans Rees' Sons*, this Court held unconstitutional North Carolina's attempt to assess an income tax on an

interstate enterprise involving leather goods. Hans Rees' Sons operated an extensive interstate business that involved the purchase of hides, their tanning, the finishing and cutting of the leather, and the sale of their products. The tannery which converted Hans Rees' Sons hides to leather was located in North Carolina, and some product sales occurred there. North Carolina, in an apparent attempt to tax the income that was attributable to the state, applied its statutory formula to Hans Rees' Sons total income. Hans Rees' Sons, however, complained that in doing so North Carolina had "credited" all sale income to "manufacturing" and that it had made no attempt to separate the profits generated by the manufacturing of leather within North Carolina from the manufacturing that occurred in finishing and cutting the leather outside the state. This Court agreed that the application of North Carolina's formula in those years "operated unreasonably and arbitrarily," and attributed to North Carolina "a percentage of income out of all appropriate proportion to the business transacted by the appellant in that state." *Hans Rees' Sons,* 283 U.S. at 135.

Like North Carolina in *Hans Rees' Sons*, Utah is attempting to tax the income generated outside its borders. Utah, however, has "apportioned" and taxed *100%* of the income generated by the interstate commerce resulting in the rocket motor sales. Utah has "credited" itself with all of the sale profits generated by an enterprise that manufactures its products only in part within the state. Taxing 100% of this income is therefore out of all appropriate proportion. In addition, this tax results in a "grossly distorted result" because of Utah's "overreaching[] beyond the values represented by the intrastate assets purported to be taxed," *Norfolk & W. Ry.* v. *Missouri State Tax Comm'n,* 390 U.S. 317, 326 (1968). "[T]he *State* is obliged . . . to make the accommodations necessary to assure that its taxing power is confined to its constitutional limits." *Id.* at 329 (emphasis added). It is no excuse for the Utah Supreme Court to claim that the tax

imposed was in conformity with its interpretation of *state* law. See U.S. Const. art. VI, cl. 2.

2. The income tax Utah imposed on Hercules also unduly burdens interstate commerce in violation of the third prong of this Court's *Complete Auto* test. "Even if a tax is fairly apportioned, it may discriminate against interstate commerce." *Amerada Hess Corp.* v. *New Jersey Taxation Div.*, 490 U.S. 66, 75 (1989). In determining whether a tax discriminates against interstate commerce, the Court has considered whether the threat of double taxation is real or merely speculative and theoretical. See *Goldberg*, 488 U.S. at 263-64 ("[t]his limited possibility of multiple taxation . . . is not sufficient to invalidate the . . . statutory scheme"); *Exxon Corp.*, 447 U.S. at 228-29 ("it is the *risk* of multiple taxation that is being asserted; actual multiple taxation has not been shown"); *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 448 (1980) (Court not confronted with "actual multiple taxation"); *Moorman*, 437 U.S. at 276 (claim that more than 100% of income was subject to tax was "speculative").

This is the clearest possible case requiring review by this Court. Here, the parties have stipulated that the rocket motor sales were taxed twice; once in either California or Washington, and then again in Utah. App. 35a. ("[t]he State of California treated the same as 'California Sales' and they were included in the 'sales factor' in computing the California Corporation Franchise Taxes"; "Petitioner paid Washington State 'Business and Occupation' tax on all such motors"). Hercules's complaint is not theoretical. "If another State has taxed the same interstate transaction, the burdensome consequences to interstate trade are undeniable." *ARMCO, Inc.* v. *Hardesty*, 467 U.S. 638, 645 n.8 (1984) (internal quotation omitted). In declining to address claims of potential, rather than actual, multiple taxation, this Court has relied on its power "to correct excessive taxation" and "to correct any gross overreaching." *Mobil*, 445 U.S. at 446-47.

The Court should now exercise that power to review the decision of the Utah Supreme Court allowing Utah to assess a tax that results in double taxation and unduly burdens interstate commerce.

3. Utah's tax not only creates an undue burden on interstate commerce, it is an unreasonable one as well. The Utah Supreme Court attempted to claim that because one of the purposes of the uniform taxing statute, UDITPA, was to avoid double taxation, and because it had adopted and applied that statute, no improper taxation could result. App. 9a. Not only is the reasoning of the Utah Supreme Court hopelessly circular, it is also inaccurately descriptive. In apportioning income on the basis of payroll, property, and sales, UDITPA's framers applied what has become known as the "destination rule" to apportion sales between the various states; "sales are attributed to the consumer state rather than the state of sales activity or the place where goods are appropriated to the orders." William J. Pierce, *The Uniform Division of Income for State Tax Purposes,* 35 Taxes 747, 780 (1957). In this way, as noted above, *supra* at 4, the sales factor estimates the contribution of market states, rather than duplicating the measurement of the contribution of manufacturing states provided by the payroll and property factors. Utah has already allocated to itself the income reflected by Hercules's payroll and property. In conformity with the uniform "destination rule" for the apportionment of sales income, both California and Washington taxed the income reflected by the rocket motor sales because those goods had been consumed in their respective states.

Even though Utah has adopted UDITPA, the Utah Supreme Court refused to apply the "destination rule." App. 6a. It is the only state that has interpreted UDITPA to reach sales income in this way. The court below allowed Utah, a manufacturing state, to claim the exclusive right to tax the profits from the rocket motor sales.

By mischaracterizing the sale as one not involving interstate commerce, Utah hopes to excise a double tax on Hercules while avoiding the limitations of the Commerce Clause. That effort by the state warrants review by this Court.

* * * *

The decision of the Utah Supreme Court conflicts with the decisions of this Court construing the Commerce Clause, and permits the state to burden interstate commerce by hindering the production of materials used by the United States for our national defense. Because only this Court can review and correct an overreaching state tax when a state supreme court refuses to do so, the Court should grant the petition.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDICES

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APPENDIX A

[Filed June 10, 1994]

IN THE SUPREME COURT
OF THE STATE OF UTAH

No. 930051

HERCULES INCORPORATED,
Plaintiff and Petitioner,

v.

UTAH STATE TAX COMMISSION, AUDITING DIVISION,
Defendant and Respondent.

Third District, Salt Lake County
The Honorable David S. Young

On Certiorari to the Utah Court of Appeals

ZIMMERMAN, Chief Justice:

Hercules Inc. petitioned this court for review of a franchise tax deficiency assessed by the Utah State Tax Commission. The Commission found a deficiency in franchise taxes paid by Hercules for the years 1977 through 1980 on missile motor parts sold to Lockheed Missiles & Space Company. After the Commission assessed the deficiency, Hercules petitioned for a redetermination. The Commission held a formal hearing and affirmed the deficiency. Following a trial de novo on the record under section

59-1-603(1) of the Code,[1] the district court reversed the Commission, holding that the sales in question were not "Utah sales" within the meaning of sections 59-13-92 and -93 of the Code.[2] The sales were therefore improperly included in calculating Hercules' franchise tax liability. The Commission appealed. The Utah Court of Appeals reversed the district court, holding that the sales in question were Utah sales and thus subject to the franchise tax. *Hercules Inc. v. Utah State Tax Comm'n*, 845 P.2d 941 (Utah Ct. App. 1992). We affirm the court of appeals.

We first summarize the relevant facts as found by the Commission. During the audit period, 1977 through 1980, Lockheed had a prime contract with the United States to build Trident missiles. Lockheed subcontracted with Hercules to build the solid-fuel rocket motors for the missiles. Hercules manufactured the motors at its Bacchus, Utah, facility. Lockheed inspected and accepted the motors at Bacchus, and title legally passed from Hercules to Lockheed and from Lockheed to the United States at Bacchus. The motors were then shipped from Utah via common carrier to military assembly facilities in either Washington or California. Once there, Lockheed assembled the motors and other missile components into the actual missile. Hercules provided supervision and other support services during this assembly.

Utah imposes a franchise tax under chapter 7, title 59 of the Code on the net income of corporations for the privilege of doing business in Utah.[3] Utah has adopted

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[1] Section 59-1-603 has been replaced by the Utah Administrative Procedures Act, ch. 161, § 314, 1987 Utah Laws 830, 980.

[2] These sections were renumbered sections 59-7-317, -318 by Title 59—Phase II Recodification, ch. 2, §§ 156, 157, 1987 Utah Laws 59, 112.

[3] During the period relevant to this case, the corporate franchise-tax portion of the Code was codified at chapter 13, title 59. In 1987, this section was renumbered chapter 7 of title 59 by Title

the Uniform Division of Income for Tax Purposes Act ("UDITPA"), which sets forth the method for apportioning the income of corporations that have income derived from, or attributable to, sources both inside and outside the taxing state. *See* Utah Code Ann. § 59-7-303(1). Under UDITPA, each state multiplies a corporation's total income by a fraction designed to reflect the income attributable to sources within that taxing state; the state then taxes this income. Utah Code Ann. § 59-7-311; *see* William J. Pierce, *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747, 750 (1957). The numerator of this fraction is the sum of three factors, the property factor, the payroll factor, and the sales factor; the denominator is three.

The sales factor for Hercules during the audit period is at issue in this case. Section 59-7-317 defines the sales factor as "a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period." Utah Code Ann. § 59-7-317. Section 59-7-318 delineates which sales of personal tangible property are deemed to be made in Utah or, in other words, "Utah sales." This section states in relevant part, "Sales of tangible personal property are in this state if . . . the property is delivered or shipped to a purchaser . . . within this state, regardless of the f.o.b. point or other conditions of sale." Utah Code Ann. § 59-7-318.

The Commission determined that the motor sales were Utah sales under Code section 59-7-317 and thus properly included within the calculation of Hercules' franchise taxes. The Commission based this decision on its findings that (i) final delivery of the motors took place at Bacchus; (ii) at the time of delivery the motors were a final prod-

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59—Phase II Recodification, ch. 2, §§ 73 to 161, 1987 Utah Laws 59, 87-113. For convenience, this opinion hereinafter uses the Code sections as currently numbered, except where otherwise noted.

uct for purposes of taxation; and (iii) Lockheed was "a purchaser 'within this state,' by virtue of its property, payroll, and sales here." *Hercules Inc. v. Auditing Div.*, No. 83-0078, slip op. at 7 (Utah State Tax Comm'n Oct. 4, 1988).

The district court reversed the Commission on the ground that "[t]he 'property' that was sold by Hercules to Lockheed under the subcontract . . . was a functional rocket motor [that] could be fired when the manufacturing process was completed." *Hercules Inc. v. Utah State Tax Comm'n*, No. 880907117 CV, slip op. at 5 (Utah Dist. Ct. Feb. 1, 1991). In other words, the district court reasoned that Hercules did not deliver a fully functional rocket motor to Lockheed in Utah, although title to the motors passed to Lockheed upon completion of the manufacturing performed at Bacchus. Such a functional unit came into existence only after further assembly of the entire missile at a seaport in Washington or California. Consequently, according to the district court, "The manufacturing process of the rocket motors was completed in the states of Washington and California, not Utah," and final delivery took place in those states. *Id.* at 11-12. The court concluded that the rocket sales were interstate sales properly allocated to Washington and California using the "destination rule." [4] *Id.* at 14-15.

In reversing the district court, the Utah Court of Appeals held that the subcontract between Hercules and Lockheed was for rocket motors that were to be used by Lockheed as component parts in building the actual missiles. *Hercules Inc. v. Utah State Tax Comm'n*, 845 P.2d 941, 943 (Utah Ct. App. 1992). The court of appeals reasoned that the subject matter of the subcontract between Hercules and Lockheed was the rocket

[4] The destination rule is used to determine how to allocate, as between states, revenues derived from interstate sales. Under the destination rule, goods are deemed to have been sold in the market state or the state of final destination. *Department of Revenue v. Parker Banana Co.*, 391 So. 2d 762, 763 (Fla. Dist. Ct. App. 1980).

motors, as they existed upon completion of the manufacturing process at Bacchus. *Id.* at 941. The court of appeals thus held that the district court had incorrectly applied section 59-7-318 in finding that these sales were not Utah sales. *Id.* at 943-44. Further, because Lockheed was doing business in Utah and was a Utah purchaser and the motors were delivered to Lockheed within Utah, the sales were Utah sales under Code section 59-7-318 and properly included in the sales factor when calculating Hercules' franchise tax liability. *Id.* at 944.

In its petition for certiorari, Hercules contends first that the destination rule makes the sales either Washington or California sales, not Utah sales. Second, it argues that it has been taxed twice on the same transaction, once by Washington or California and again by Utah, in violation of the Commerce Clause of the United States Constitution. We address these arguments in order.

Hercules first argues that in calculating a corporation's tax liability, UDITPA case law from other states and scholarly commentary uniformly conclude that the destination rule should govern the characterization of sales. Under that rule, the destination of the goods sold determines the location of the sale, rather than the point at which title passes or other conditions of the sale that the parties can manipulate. Hercules contends that the rocket motors in question were ultimately shipped to and "consumed" in Washington or California, and thus, the destination rule requires that we characterize the sales as occurring in one of those states.

The interpretation of sections 59-7-317 and -318 of the Code presents a question of law, which we review for correctness. *See Sandy City v. Salt Lake County*, 827 P.2d 212, 218 (Utah 1992); *Ward v. Richfield City*, 798 P.2d 757, 759 (Utah 1990). On questions of statutory construction, we first consider the plain language of the statute. "Only if we find some ambiguity need we look further." *Shurtz v. BMW of N. Am., Inc.*, 814

P.2d 1108, 1112 (Utah 1991); *see Bonham v. Morgan*, 788 P.2d 497, 500 (Utah 1989).

Section 59-7-318(1) states, "Sales of tangible personal property are in this state *if . . . the property is delivered or shipped to a purchaser . . . within this state*, regardless of the f.o.b. point or other conditions of the sale." (Emphasis added.) In this case, the motors were transferred to Lockheed, a Utah purchaser, in Utah, as finished components to be used by Lockheed in building the actual missiles. This makes the sales Utah sales for purposes of the statute.

The district court found, "The 'property' that was sold by Hercules to Lockheed was a functional rocket motor [that] could be fired when the manufacturing process was completed." *Hercules Inc. v. State Tax Comm'n*, No. 880907117 CV, slip op. at 5 (Utah Dist. Ct. Feb. 1, 1991). This led the district court to conclude that the property was not delivered until the missile's manufacturing process was completed at the seaport assembly point. *Id.* at 11-12. The court of appeals disagreed with this characterization of the contract's terms. *Hercules Inc. v. Utah State Tax Comm'n*, 845 P.2d 941, 943 (Utah Ct. App. 1992). We agree with the court of appeals. The sale between Hercules and Lockheed is completed prior to Lockheed's final installation of the motors as part of the missile assembly process. The subcontract between Hercules and Lockheed was for motors that could be used by Lockheed in assembling the missiles and would be functional when the process was completed (similar to a warranty). The sale of the motors from Hercules to Lockheed was completed in Utah in accordance with section 59-13-93 of the Code. Although final assembly was required to produce a missile, this did not make the sale of the finished motors incomplete upon delivery at Bacchus.

Further, we reject Hercules' arguemnt that the destination rule applies here. That rule applies only to interstate

sales. Hercules would have us read the statute to require "consumption" and thus make these transactions interstate. The statute does not use the term "consumption," and the location of consumption of the goods cannot be read into the statute to defeat its plain language.

For purposes of Hercules' Utah franchise tax liability, the status of the sales is "simply determined by whether such property, when sold, is delivered or shipped to a purchaser within" Utah.[5] *Bullock v. Enserch Exploration, Inc.*, 614 S.W.2d 215, 217 (Tex. Civ. App. 1981), *cert.*

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[5] Hercules' reliance on comments by Professor William Pierce, an expert on UDITPA, is misplaced. *See* William J. Pierce, *The Uniform Division of Income for State Tax Purposes*, 35 Taxes 747 (Oct. 1957). Even if the destination rule applied to this case, Utah would be considered the manufacturing state and the consumer state. Under the destination rule, the location of the purchaser determines the destination of the goods because the words "within this state" in the statute modify the word "purchaser." *See Pabst Brewing Co. v. Wisconsin Dep't of Revenue*, 387 N.W.2d 121, 123 (Wis. Ct. App.) ("[T]he location of the purchaser controls."), *review denied*, 391 N.W.2d 209 (Wis. 1986). *Hercules stipulated that Lockheed was doing business in Utah.* Because Lockheed was a Utah purchaser, not an out-of-state purchaser, the motor sales were Utah sales.

Hercules cites a number of cases in which the destination rule was applied and contends that they require us to decide this case in its favor. Every case is factually distinguishable from the case at hand. All but one involve *out-of-state purchasers* making dock sales in which the purchasers only came in-state to pick up the goods sold. These include *Texaco, Inc. v. Groppo*, 574 A.2d 1293, 1294 (Conn. 1990); *Department of Revenue v. Parker Banana Co.*, 391 So. 2d 762, 762-63 (Fla. Dist. Ct. App. 1980); *Strickland v. Patcraft Mills, Inc.*, 302 S.E.2d 544, 544 (Ga. 1983); *Olympia Brewing Co. v. Commissioner of Revenue*, 326 N.W.2d 642, 644 (Minn. 1982); *Pabst Brewing Co.*, 387 N.W.2d at 122. Similarly, *Howmet Corp. v. Revenue Division* involved the out-of-state solicitation of sales to out-of-state purchasers. *Howmet Corp. v. Revenue Div.*, No. 87-11161-CM, 1993 WL 45075, at *1 (Mich. Ct. Cl. Jan. 2, 1993) (not reported). Lockheed is not an out-of-state purchaser coming in-state to make a purchase, nor does this case involve an out-of-state solicitation of sales.

denied, 455 U.S. 946 (1982). Hercules delivered the motors to Lockheed in Utah, making the sales Utah sales properely included in the calculation of Hercules' franchise tax liability.

Hercules next argues that Utah has imposed a double tax on Hercules' income in violation of the Commerce Clause of the United States Constitution. U.S. Const. art I, § 8. That provision requires the fair apportionment of income among the taxing states. *See Goldberg v. Sweet*, 488 U.S. 252, 260-61 (1989). Hercules contends that California and Washington properly taxed Hercules using the destination rule and that Utah's taxation of the same income unfairly ignores California's and Washington's contributions to the production of that income.

Whether Utah's taxation of the income produced by the sales between Hercules and Lockheed violates the Commerce Clause is a question of law, which we review for correctness. *See Questar Pipeline Co. v. Utah State Tax Comm'n*, 817 P.2d 316, 317-18 (Utah 1991); *Savage Indus., Inc. v. Utah State Tax Comm'n*, 811 P.2d 664, 667 (Utah 1991). To prevail on a Commerce Clause challenge, a taxpayer "must demonstrate that there is 'no rational relationship between the income attributed to the state and the intrastate values of the enterprise' " being taxed. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 180 (1983) (quoting *Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 220 (1980)). This is accomplished by proving with " 'clear and cogent' evidence that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted . . . in that State,' or has 'led to a grossly distorted result.' " *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978) (quoting *Hans Rees' Sons, Inc. v. North Carolina*, 283 U.S. 123, 135 (1931); *Norfolk & Ws. Ry. v. Missouri State Tax Comm'n*, 340 U.S. 317, 326 (1968)).

The key to this determination is whether Utah correctly allocated the motor sales to Utah for purposes of taxa-

tion, and we have already concluded that it did. *See Chicago Bridge & Iron Co. v. State Tax Comm'n*, 839 P.2d 303, 308-09 (Utah 1992). Because Utah is not taxing sales in another state, the subsequent out-of-state installation of goods sold in this state does not affect the local nature of the sales transactions. Utah does not violate the Commerce Clause by properly taxing transactions occurring solely within this state.

The purpose of UDITPA is to establish proper taxation among the various states. Multiple taxation is a result of improper taxation. Utah's taxation of Hercules was proper. Utah is not responsible for taxes that may have been improperly imposed by other jurisdictions. The fact that another state was the first to tax a transaction is irrelevant.

The court of appeals' decision is affirmed.

WE CONCUR:

I. DANIEL STEWART
Associate Chief Justice

RICHARD C. HOWE
Justice

CHRISTINE M. DURHAM
Justice

PAMELA T. GREENWOOD
Court of Appeals Judge

Greenwood, Court of Appeals Judge, sat to fill a vacancy on the Court.

APPENDIX B

[Filed Dec. 31, 1992]

IN THE UTAH COURT OF APPEALS

Case No. 920548-CA

HERCULES INCORPORATED,
Plaintiff, Appellee, and Cross-Appellant,

v.

UTAH STATE TAX COMMISSION,
Defendant, Appellant, and Cross-Appellee.

Third District, Salt Lake County
The Honorable David S. Young

Before Judges Billings, Jackson, and Russon.

JACKSON, Judge:

Appellant (Tax Commission) appeals a decision of the Third Judicial District Court Tax Division entitling appellee (Hercules) to recover the tax in controversy plus interest. We reverse.

FACTS

During the years 1977 through 1980, the United States Government had a contract with Lockheed Missiles & Space Company (Lockheed) to build Trident missiles.

Lockheed subcontracted with Hercules to build the missile motors.[1] Hercules manufactured the motors at its Bacchus, Utah facility. Upon completion of the manufacturing process, Lockheed, who had a business presence in Utah, inspected the motors and received title to them at the Bacchus facility. At this point, the subcontract items consisted of the unconnected first, second, and third stage motors of the missile—three canisters containing an explosive propellant in an inert form. The units were then shipped from Utah via common carrier, on a government bill of lading, to a military assembly facility at a seaport in one of several destination states. It was Lockheed's contractual obligation at each of these facilities to assemble the components of the missile. Hercules, under its subcontract, provided many support services at these facilities. Hercules was compensated by a cost-plan, fixed fee contract calling for partial payment upon delivery to Lockheed at Bacchus, as well as additional payment for services performed at the destination facilities. Payment was also based on component performance.[2] The contract provided for incentives rewarding good performance and penalties discouraging bad performance.[3]

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[1] Much confusion exists over the definition of "missile motor." Thus, it is important at the outset to distinguish between the missile motor, the missile propulsion subsystem, and the completed missile. The record and the subcontract show that the motor is essentially three large canisters filled with "tooled" explosives. The motor is a component of the propulsion subsystem. In addition to the motor, the propulsion subsystem consists of firing units, actuators, adaptor sections, and various other components. The propulsion subsystem, together with the re-entry bodies, the nose fairing and the nose cap, make up the completed missile.

[2] A missile motor is not like a car motor. The missile motor is capable of being fired one time only. Once the motor is ignited the "tooled" explosives burn at a steady pace until they burn out. The missile cannot be test-fired to check performance. Consequently, performance-based payments are not received until the missile is actually deployed.

[3] Lockheed had supervisors at the Hercules facility and Hercules had supervisors at the destination facility. Each had to "sign off"

In 1982, the Auditing Division of the Tax Commission issued a "Notice of Deficiency" to Hercules claiming additional Utah Corporate Franchise taxes were due for the years 1977 through 1980. On October 4, 1988, the Tax Commission, after a formal hearing, affirmed the audit deficiency. On November 2, 1988, Hercules paid $890,462.00 as a prerequisite to appealing the decision to the Third Judicial District Court. *See* Utah Code Ann. § 59-1-505 (1987). Of that amount, $456,512.00 was paid under protest. On February 1, 1991, the district court reversed the Tax Commission's Final Decision and held that Hercules was entitled to a refund with interest on the taxes paid under protest. The Tax Commission appealed the case to the Utah Supreme Court, which transferred the case to us.

ISSUE

This appeal involves the application of Utah Code Ann. § 59-13-93 (1967) to Hercules' sale of missile motors to Lockheed. The Uniform Division of Income for Tax Purposes Act (UDITPA), governs the amount of taxes payable to Utah when income is derived from both within and without the state. Utah Code Ann. § 59-13-79 (1967). The business income to be apportioned to this state is determined by "multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three." Utah Code Ann. § 59-13-86 (1967). The sales factor is a fraction, "the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period." Utah Code Ann. § 59-13-92 (1967). Sales of tangible personal property are "in this state" if the property is "delivered or shipped

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on the work completed by the other. This arrangement is necessary considering both stood to benefit financially from work done by the other if the missile performed successfully.

to a purchaser within this state regardless of the f.o.b. point or other conditions of the sale." Utah Code Ann. § 59-13-93 (1967). The issue in this case is what tangible personal property was sold by Hercules to Lockheed.

ANALYSIS

The trial court made several findings of fact concerning the subject matter of the sale. The trial court found that the "property" to be sold by Hercules to Lockheed under the subcontract was "a functional rocket motor, which could be fired when the manufacturing process was completed." The trial court found that upon the completion of manufacturing in Utah, the subcontract items "were not a 'rocket motor' or functional unit that could be fired," and at that point "the total manufacturing process of the motors being purchased was approximately 60% complete." The trial court further found "the manufacturing process was completed at the destination assembly facility."

We review a trial court's findings of fact under a clearly erroneous standard, giving great deference to the trial court's findings. *Grayson Roper Ltd. v. Finlinson,* 782 P.2d 467, 470 (Utah 1989); Utah R. Civ. P. 52(a). To successfully attack a trial court's findings of fact, an appellant must "demonstrate that the evidence, including all reasonable inferences drawn therefrom, is insufficient to support the findings." *Grayson,* 782 P.2d at 470.

We find the evidence insufficient to support the trial court's findings. The record clearly demonstrates that the subject of the Hercules-Lockheed subcontract was a missile motor with accompanying services. The motor is not functional when it leaves Hercules' Bacchus facility. It is only functional when it is assembled into a missile. The court erred when it found the subject matter of the Hercules sale to Lockheed was a functional or usable motor that could be fired. In essence, the court found the subject matter of the sale to be a completed missile.

This simply is not the case. Lockheed, as the prime contractor, sold completed missiles to the government. Hercules, as a subcontractor, sold a motor that was a component of the missile's propulsion subsystem.

The trial court found that the motor was not functional when it left Hercules' Bacchus facility, that the manufacturing process was only 60% complete, and that the manufacturing process would not be fully complete until further work was performed at the destination facility. It is clear from the record that the trial court has confused the missile motor with the missile propulsion subsystem.[4] The motor was 100% complete in Utah and comprised approximately 60% of the propulsion subsystem. The director of contract policy implementation for Hercules testified at the formal hearing before the Tax Commission that "[w]hen we finish a motor, we complete it to a drawing. It's not a usable motor at that point, but we complete all the operations that Bacchus is responsible for. Then Lockheed will sign off and say, 'We accept this motor.' " No motor is functional without some way to "turn it on." Hercules sold Lockheed a completed missile motor. Lockheed combined it with other components necessary to "turn it on." The manufacturing of the missile motor was completed at Hercules' Bacchus facility. The manufacturing of the propulsion subsystem and ultimately the entire missile was completed at the destination facility. The tangible personal property contracted for by Hercules and Lockheed, and the subject matter of the sale generating the business income to be apportioned, was the missile motor as it left Hercules'

[4] We reemphasize the difference between the missile motor and the missile propulsion subsystem. The propulsion subsystem consists of the first, second, and third stage motors, firing units, and various other components. Without these additional components, the motor is just as unusable as a car motor before adding the starter, ignition switch, and other components.

Bacchus facility.[5] The trial court's findings with respect to the property are clearly erroneous.

Section 59-13-93 of UDITPA states that sales of tangible personal property are in this state if "the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of the sale." Utah Code Ann. § 59-13-93 (1967). Giving no regard to the f.o.b. point or other conditions of the sale, the sale in this case is a Utah sale if "the property is delivered or shipped to a purchaser within this state."

The trial court applied this statutory language to erroneous facts incorrectly concluding the sale at issue in this case was not a Utah sale. Applying section 59-13-93 to the motor as it left Hercules' Bacchus facility leads to only one reasonable conclusion: the sale of the missile motor was a Utah sale. Lockheed received the completed missile motors in Utah and is a Utah purchaser.[6] Under

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[5] Hercules bases most of its arguments on the fact that its contractual obligations continued after the motor left the Bacchus facility. The subcontract between Hercules and Lockheed was for the sale of property and services. Hercules' post-sale contractual obligations were mainly for services and are listed in the subcontract under the heading "Technical Support Services." The only issue before us is the apportionment of business income generated by the sale of property. The issue of income generated by the sale of services is not properly before us and we do not decide that issue.

[6] Hercules cites several cases for the proposition that for purposes of determining in which state a sale takes place, the destination or consumption rule should be applied. *See Dep't of Revenue v. Parker Banana Co.*, 391 So.2d 762, 764 (Fla. Ct. App. 1980) (a purchaser from outside the state does not become a purchaser within the state merely by sending a representative to pick up the goods); *Olympia Brewing Co. v. Comm'r of Revenue*, 326 N.W.2d 642, 647 (Minn. 1982) (delivery terminates where initial purchaser is located); *Strickland v. Patcraft Mills, Inc.*, 302 S.E.2d 544, 545 (Ga. 1983) (court applied destination test to determine where sale to out-of-state customer took place). Each of these cases, however, deals with an out-of-state purchaser coming in state to pick up the subject matter of the sale. In the case before us, it is undisputed

§ 59-13-93, Hercules' sale of missile motors to Lockheed is a sale within this state. The trial court's conclusion to the contrary is incorrect.

CONCLUSION

The Auditing Division of the Tax Commission properly assessed additional Utah Corporate Franchise taxes on Hercules for the years 1977 through 1980. During that period, Hercules sold missile motors to Lockheed. The motors contracted for were the motors as they left Hercules' Bacchus, Utah facility. The buyer, Lockheed, was doing business in Utah and was a Utah purchaser. The sale was hence a Utah sale under Utah Code Ann. § 59-13-93 (1967), and properly included in the sales factor used to apportion business income under Utah Code Ann. § 59-13-92 (1967). The Tax Commission's apportionment of Hercules' business income generated from the sale of the missile motor was proper under Utah Code Ann. § 59-13-86 (1967).

Accordingly, we reverse the trial court's decision to the contrary.

/s/ Norman H. Jackson
NORMAN H. JACKSON
Judge

WE CONCUR:

/s/ Judith M. Billings
JUDITH M. BILLINGS
Judge

/s/ Leonard H. Russon
LEONARD H. RUSSON
Judge

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that Lockheed is a corporation present and doing business within the state of Utah. Lockheed is a Utah purchaser. Accordingly, we do not reach appellee's Commerce Clause argument because no interstate sale occurred.

APPENDIX C

[Filed Feb. 1, 1991]

IN THE DISTRICT COURT
OF THE THIRD JUDICIAL DISTRICT
IN AND FOR SALT LAKE COUNTY
STATE OF UTAH
TAX DIVISION

Civil No. 880907117 CV

HERCULES INCORPORATED,
Petitioner/Plaintiff,
vs.

UTAH STATE TAX COMMISSION, R. H. ("HAL") HANSEN, Chairman, G. BLAINE DAVIS, Commissioner; JOE B. PACHECO, Commissioner; ROGER O. TEW, Commissioner; individually and in their official capacities as commissioners of the Utah State Tax Commission,
Respondents/Defendants.

MEMORANDUM DECISION

This matter is before the Court pursuant to the Utah Tax Court Act, Utah Code Ann., Section 59-1-601, et seq., (1987), on an Appeal, Petition for Review and Complaint of the Final Decision of the Utah State Tax Commission, issued October 4, 1988. Based upon Section 59-1-603(1) of the Tax Court Act, this proceeding is before the Tax Division of the Third District Court as an "original, independent proceeding . . . tried without a jury and de novo."

The Court conducted a "trial de novo on the record" in this proceeding on October 22, 1990 at which trial the

petitioner/plaintiff Hercules Incorporated ("Hercules") was represented by Keith E. Taylor and Maxwell A. Miller of Parsons, Behle and Latimer. The respondents/defendants Utah State Tax Commission and other individually named Commissioners of the Utah State Tax Commission ("Tax Commission") were represented by Brian L. Tarbet, Assistant Utah Attorney General.

Based upon the record of the informal and formal hearings before the Tax Commission, the parties' respective briefs and Memoranda, oral argument at the "trial de novo on the record," and the Court being fully advised in the premises, the Court, pursuant to Rule 52 of the Utah Rules of Civil Procedure, now, therefore, enters its Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. In 1982, the Auditing Division of the Tax Commission issued a "Notice of Deficiency" to Hercules claiming that additional Utah Corporate Franchise taxes were due for calendar years 1977 through 1980.

2. Under date of October 28, 1982, Hercules filed a "Petition for Redetermination" with the Tax Commission.

3. Under date of March 11, 1983, Hercules filed a "Supplement to Petition for Redetermination" with the Tax Commission.

4. Under date of August 24, 1987, Hercules and the Auditing Division signed a "Formal Pre-Hearing Stipulation."

5. The sole issue to be resolved before the Tax Commission, based upon the Stipulation of the parties, was:

> The issue to be resolved in the proceeding is: Are missile motors manufactured in Utah by Hercules and sold to Lockheed under a subcontract and then sold by Lockheed to the United States under a prime contract, for use by the United States in submarines

situated on the east and west coasts of the United States, "Utah sales" which may be properly included in the "sales factor" under the provisions of Utah Code Ann., Section 59-13-93 in computing Utah Corporation Franchise Tax?

6. The Stipulation also set forth the following uncontroverted facts which the Court hereby adopts:

a. The additional tax claimed to be due to the Utah State Tax commission by the Auditing Division for the audit period of (1977-80) is the sum of $467,598.00. Of that sum, $238,882.00 is at issue in this proceeding. The Auditing Division also claims that interest is due on the final additional tax found to be due, if any, which will run until the date of payment.

b. David R. Peirson, Manager of the State and Local Tax Department of Petitioner at Wilmington, Delaware, if called as a witness at the Formal Hearing, would testify:

1. Some of the motors here involved were shipped to the State of Washington during each of the years in the audit period. Petitioner/plaintiff paid Washington State "Business and Occupation" tax on all of such motors. The State of Washington concluded that "final delivery does not occur until the rocket motors are installed in Washington" as a basis for imposing this tax.

2. Some of the motors here involved were shipped to the State of California during each of the years in the audit period. The State of California treated the same as "California Sales" and they were included in the "sales factor" in computing the California Corporation Franchise Taxes for Hercules during the audit period.

c. Petitioner is taxable in each state to which motors were delivered or shipped during the audit period.

d. The rocket motors which are the subject of this proceeding were manufactured by the petitioner/plaintiff as a subcontractor and were sold to Lockheed as prime contractor. During the audit period Lockheed had employees stationed in Utah and did business in Utah. Lockheed, in turn, sold the same to the United States as part of the United States' defense system. During the audit period, the United States had presence in Utah and did business in Utah.

e. The rocket motors passed inspection by Lockheed and by the United States at Bacchus, Utah and title passed from Hercules to Lockheed and from Lockheed to the United States at Bacchus, Utah.

f. Petitioner had continuing contractual responsibilities for the rocket motors after passage of title to the motors of Lockheed and to the United States at Bacchus, Utah. Such responsibilities included avoiding injury or damage or defects discovered during handling, storage, assembly and installation of the motors in the rockets of which they became a part.

g. The purpose of the rocket motors which are the subject of this proceeding is to serve as the launching and delivery mechanism for military rockets finally assembled and installed in submarines at coastal cities in the United States.

7. In addition, the uncontroverted testimony presented at the formal hearing before the Tax Commission, held August 24, 1987, established the following facts which the Court hereby adopts:

8. The "property" that was sold by Hercules to Lockheed under the subcontract and by Lockheed to the United States under the prime contract was a functional rocket motor, which could be fired when the manufacturing process was completed; the rocket motor was finally

accepted by Lockheed, and then, in turn, by the United States. The military rockets contained three motors. The principal component of each rocket motor was a casing or container which was filled with a potentially explosive propellant. The propellant was tooled in a manner to control the speed with which the propellant would burn when ignited. This component was manufactured in Utah by Hercules and Lockheed. Hercules provided materials and hands-on work. Lockheed exercised supervisory and inspection control to assure that specifications were met.

9. Upon completing the manufacturing of this component in Utah, Lockheed completed an inspection of the unit, accepted the same for the purpose of satisfying the delivery schedules and providing substantiation for billing. Title to the subcontract items passed from Hercules to Lockheed to the United States. At that time, the subcontract items were not a "rocket motor" or functional unit that could be fired, but essentially a casing containing a potentially explosive propellant, then in an inert form to facilitate interstate transportation to a seaport assembly facility. At that point, the total manufacturing process of the motors being purchased was approximately 60% complete.

10. The units were then placed in a shipping container and shipped from Utah on a common carrier, usually on a Government Bill of Lading, which listed Hercules as the "Shipper" and the military assembly facility at a seaport in the destination as the consignee.

11. The rocket motor, which was the subject of this prime and subcontract of sale was comprised of many other necessary component parts, some of which were supplied by Hercules and some of which were supplied by Lockheed, the United States or third parties. These other components were installed and the manufacturing process was completed at the destination assembly facility.

12. At the destination facility, the hands-on work was reversed—Lockheed performed the hands-on work, and

Hercules exercised supervisory and inspection control to assure that specifications were met. Hercules' responsibilities included design of buildings, facilities and equipment, writing of procedures, training of Lockheed and government employees, supplying competent parts, supplying tools, equipment and supervision and inspecting every stage of the operation. The military assembly facility was comprised of a number of different buildings in which various assembly functions were performed. Hercules was required to supervise and inspect all functions in each of the buildings at every stage of the process. The motors could not move from building to building on assembly lines without the written certification of Hercules that all contract specifications had been met to that point. Hercules' nickname at the Washington facility was "motor mother."

13. When defects in the rocket motors were found at the assembly facility, they would be repaired in one of two ways. If the defect was minor, it would be repaired by Lockheed employees at the site under the direction of Hercules employees. If the defect was major, the motor would be returned to Utah for hands-on repair by Hercules.

14. The final step in the manufacturing and assembly process, after each of the three rocket motors was complete and could be ignited or fired, was to connect them together to become an operating rocket. At that point, Hercules accepted the Lockheed hands-on work and signed off on the assembled rocket. Then, Lockheed certified the final acceptance of the same, followed by a similar final acceptance by the United States. At that point, the United States took possession of the assembled rocket motor, attached the nuclear war head or other cargo and placed the same in a canister for storage or loading into Navy submarines at the assembly site.

15. After final acceptance by the United States, Hercules continued to have responsibility for any defects that

were discovered by its final inspection at the assembly facility.

16. Hercules was compensated by a cost-plus, fixed-fee contract calling for periodic progress payments as costs were incurred and as the manufacturing process progressed at both the Utah and the destination facilities. The contract provided for both incentives to reward good performance and penalties to deter bad performance. The compensation which Hercules received from these sales did not distinguish between work performed in the origin and destination states.

17. Hercules as seller and Lockheed as buyer can manipulate and control the F.O.B. point and most other incidents of sale of these motors to meet their own objectives, including minimizing the tax consequences of these sales. The manipulable incidents include: (1) inspection; (2) acceptance; (3) passage of title; (4) transfer of possession; and (5) method of transportation. On other contracts, these incidents have frequently been manipulated in the past by Hercules. However, Hercules as seller and Lockheed as buyer cannot manipulate the place of final destination or use of these rocket motors. The destination must be a seaport with major assembly facilities costing many millions of dollars.

18. On October 4, 1988, the Tax Commission, after formal hearing, issued its Findings of Fact, Conclusions of Law and Final Decision, a copy of which is attached as Exhibit "B".

19. The Tax Commission's Final Decision, issued October 4, 1988, affirmed the audit deficiency in favor of the Tax Commission's Auditing Division.

20. On November 2, 1988, pursuant to Utah Code Ann., Section 59-1-505 (1987), Hercules paid $890,462.00, which amount includes tax and interest, to the Tax Commission as a prerequisite to taking its appeal to this Court. $456,512.00 of the total $890,462.00 is contested and was paid under protest.

21. Before this Court are four causes of action raised in Hercules' Amended Appeal, Petition for Review and Complaint: First, whether the Tax Commission erroneously held that the sales at issue were Utah sales within the meaning of Utah's Uniform Division of Income for Tax Purposes Act ("UDITPA"), Utah Code Ann., Section 59-13-93, et seq. (1987), recodified at Utah Code Ann., Section 59-13-97, et seq. (1990); second, whether the Tax Commission's ruling, which imposed corporate franchise taxes on Hercules under UDITPA, violated the Commerce Clause of the United States Constitution; third, whether the Tax Commission's conduct of the formal hearing below deprived Hercules of due process of law as secured by the United States and Utah Constitutions; fourth, whether the Tax Commissioners' conduct of the formal hearing below deprived Hercules of due process of law as secured by the United States and Utah Constitutions.

22. Hercules' Amended Complaint also raised a Fifth Cause of Action against the Tax Commissioners, but the parties have stipulated that the Fifth Cause can be dismissed.

23. Hercules acknowledged at oral argument that the Third and Fourth Causes of Action could be dismissed for mootness if Hercules succeeds on its first two causes.

24. This Court's findings which are inconsistent with the Tax Commission's Findings of Fact are as follows:

(a) The manufacturing process of the rocket motors was completed in the states of Washington and California, not Utah, contrary to Tax Commission's Finding of Fact 1.

(b) For tax purposes, the motors were not a final product until delivery to the United States Government in the states of Washington and California, contrary to Finding of Fact 2.

(c) Final delivery took place in the states of Washington and California, not at Bacchus, Utah, contrary to Finding of Fact 3.

(d) Hercules' responsibilities to Lockheed continued until and beyond arrival at the final delivery point in the states of Washintgon and California, contrary to Finding of Fact 4.

(e) The case of *Bullock v. Enserch Exploration, Inc.*, 614 S.W.2d 215 (Tex.Civ.App. 1981), cited by the Tax Commission, is not on point because it rejects the "final destination" rule adopted by a majority of jurisdictions in the United States and does not conform to the facts of the present case, contrary to Finding of Fact 5.

(f) Hercules paid Washington State "business and occupation" tax on the motors at issue and is subject to multiple taxation on the same transaction that the Tax Commission seeks to tax, contrary to Finding of Fact 6, and contrary to the Formal Pre-Hearing Stipulation at 3a.

(g) The so-called "throw-back" rule is not a relevant factual determination, contrary to Finding of Fact 6. To the extent the "throw-back" rule may be relevant, it applies to sales by Lockheed to the United States, not to sales by Hercules.

(h) As a result of the Tax Commission's ruling, Hercules paid taxes on these transactions under protest. Hercules has paid a double-tax on the sale of the motors at issue, once to either the states of Washington or California, and again to the state of Utah.

CONCLUSIONS OF LAW

1. Two of the paramount purposes of the Uniform Division of Income for Tax Purposes Act ("UDITPA"), Utah Code Ann., Section 59-13-93, et seq. (1974 and Supp. 1981), recodified at Utah Code Ann., Section 59-7-301 (1990), are to achieve uniformity in the tax-

ation of corporate income among the states and to avoid duplicate or double taxation.

2. UDITPA attempts to achieve these objectives by allocating income according to a three-factor formula. One factor in the formula is the "sales factor" which is a ratio, the numerator of which should be Hercules' sales made in Utah, and the denominator of which should be Hercules' total sales. After an appropriate factor is calculated under UDITPA, also using a property and payroll factor, the resulting ratio is multiplied by Hercules' net income. That figure is then multiplied by an appropriate tax rate. The result is the tax owed to Utah.

3. In determining whether certain sales should be allocated to one state or another, all state appellate courts which have considered the issue have adopted the "destination" rule, which is that the "sale" of identifiable, tangible personal property is deemed to have been made in the "market state" or state of final destination. These decisions include *Department of Revenue v. Parker Banana Co.*, 391 So.2d 762 (Fla. Dist. Ct. App. 1980); *Olympia Brewing Co. v. Commissioner of Revenue,* 326 N.W.2d 642 (Minn. 1982); *Pabst Brewing Co. v. Wisconsin Department of Revenue,* 387 N.W.2d 121 (Wis. Ct.App. 1986); and *Strickland v. Patcraft Mills, Inc.*, 302 S.E.2d 544 (Ga. 1983). The action of the taxing authorities in the states of California and Washington in imposing an income tax on these sales is consistent with these cases.

4. This Court adopts the "destination" rule because it is consistent with UDITPA's underlying purpose and the decisions referenced above.

5. The sales at issue in this case are not Utah sales.

6. Application of the "destination" rule in this case is even more compelling than in the cases cited by Hercules because the motors here at issue, unlike beer, carpet or bananas, were not a final product; that is, they were not a functioning motor, as required in the contract be-

tween Hercules and Lockheed, until final assembly and acceptance of the functional motor by Lockheed at the destination states.

7. The Commerce Clause of the United States Constitution precludes the states from discriminating against Interstate Commerce. In order to meet the "external consistency test" developed by the decisions of the United States Supreme Court interpreting the Commerce Clause, the state must tax only the portion of revenue from the interstate activity which reasonably reflects the in-state component of the activity being taxed.

8. The sales at issue in this case are interstate sales.

9. As a result of the Tax Commission's decision, Hercules has been taxed twice for the same transaction.

10. Hercules, Third and Fourth Causes of Action relate to the alleged violations of due process of law Hercules suffered as a result of the Tax Commission's use of improper and unlawful procedures in adjudicating Hercules' Petition for Redetermination. These causes of action are moot, and therefore, need not be decided, as a result of this Court's ruling that the sales at issue are not Utah sales. Hercules' Fifth Cause of Action is dismissed pursuant to the parties' Stipulation.

11. The Tax Commission's final decision is reversed.

12. Hercules is entitled to a refund with appropriate interest on the amount of taxes and interest it paid under protest.

Counsel for Hercules is directed to prepare a Judgment according to these Findings of Fact and Conclusions of Law.

Dated this 1st day of February, 1991.

/s/ David S. Young
DAVID S. YOUNG
District Court Judge

APPENDIX D

BEFORE THE STATE TAX COMMISSION OF UTAH

Appeal No. 83-0078

HERCULES, INC.,
Petitioner,

v.

AUDITING DIVISION OF THE
UTAH STATE TAX COMMISSION,
Respondent.

FINDINGS OF FACT, CONCLUSION OF LAW, AND FINAL DECISION

STATEMENT OF CASE

A formal hearing was held August 24, 1987 in response to an appeal by Hercules, Inc., Petitioner, from an informal hearing decision, dated November 12, 1986, in favor of the Respondent, the Utah State Tax Commission. Commissioners G. Blaine Davis and Joe B. Pacheco heard the matter for and on behalf of the Commission. Keith E. Taylor, Attorney at Law, represented the Petitioner. Adonis H. Nelson, Jr., Director, Contract Policy Implementation, Hercules, Inc., Bacchus, Utah; and Stanley M. Matthews, retired former Resident Manager, Hercules, Inc., Bangor, Washington, appeared as witnesses for Petitioner. Mary Beth Walz, Assistant Attorney General, represented Respondent. Kim Ferrell, Managing Auditor, Corporate Franchise Tax Section; and Karl Nelson, Auditor, Utah State Tax Commission, appeared as witnesses for Respondent. At issue is whether certain of Petitioner's

rocket motor sales to Lockheed Missile and Space Company are properly included in the "sales factor" provided for in Utah's Uniform Division of Income for Tax Purposes Act (UDITPA), Utah Code Ann. § 59-77-318 (Supp. 1987) [renumbering Utah Code Ann. § 59-13-93 (1953)]. The parties made pre-hearing stipulations which are included in Appendix A.

Petitioner's rocket motors are manufactured to specifications and sold, under subcontract, to Lockheed—who, under general contract, then sells the rocket motors to the U.S. Government. Both Lockheed and the U.S. Government engineers oversee the manufacturing process. After final inspections by Lockheed and U.S. engineers, the motors are shipped, via a government bill of lading, to various points in the United States. For the audit period in question, the majority of the motors were shipped to the U.S. Naval Base in Bangor, Washington. Once received at Bangor, U.S. Navy and Lockheed personnel, under Petitioner's supervision, assemble the motors into rockets for use in the U.S. defense system.

Petitioner asserts that these sales to Lockheed are not Utah sales as defined by UDITPA, and should therefore not be calculated into the "sales factor" for the following reasons:

1. Under Utah's UDITPA, Utah Code Ann. § 59-7-318(a), in order to be considered a Utah sale, the property must be "delivered or shipped to a purchaser . . . within this state regardless of F.O.B. point, or other conditions of the sale . . . ." The final delivery point, as contemplated by the parties, is the point at which the motors become functional. Until the motors are assembled by Lockheed and Navy personnel at Bangor, Washington, they are inert and incapable of functioning as rocket motors. Until the motors are assembled the transaction is incomplete, and, therefore, final delivery does not occur "within this state," as required by the UDITPA.

2. One of the purposes of the Multi-State Tax Compact, to which Utah and Washington are parties, is to "[a]void duplicative taxation." Utah Code Ann. § 59-1-801 Art. I(4). Since the subject sales are taxed in Washington under that state's "Business and Occupation" tax, Utah's imposition of a tax on the sales will cause duplicative taxation.

3. The logical point for taxation to occur is the point of consumption since it is the least manipulatable of all points. All other points—points of title passage, acceptance, inspection, and F.O.B.—are manipulable by the parties, making it theoretically possible to develop "nowhere" income—income not subject to tax in any state.

4. Courts in Florida, Minnesota, Wisconsin, and Georgia have adopted the "point of consumption" as the sales point and have held that the UDITPA provisions in their respective tax codes do not impose a tax on out-of-state wholesalers who enter the respective states to purchase items for shipment to and resale at points outside of the state. (Petitioner asserts that these cases are on point and should persuade the Commission to adopt a "point of consumption" interpretation of the rule.) See *Department of Revenue v. Parker Banana*, 131 So. 2d 762 (Fla. Dist. Ct. App. 1981), *Olympia Brewing Co. v. Commissioner of Revenue*, 326 N.W. 2d 642, (Minn. 1982), *Pabst Brewing Co. v. Department of Revenue*, St. Tax Cas. Rep. (CCH) Paragraph 202-304 (Wis. Ct. App. Aug. 25, 1983) *Pabst Brewing Co. v. Department of Revenue*, St. Tax Cas. Rep. (CCH) Paragraph 202-727 (Wis. Ct. App. March 25, 1986).

5. Petitioner's continuing duties and responsibilities at the Bangor facility are evidence that the transaction is not considered final until the motors are assembled and ready for test launch.

Based on the foregoing arguments, the Petitioner requests that the subject sales not be factored into the UDITPA "sales factor."

The Respondent asserts that the rocket motor sales are Utah sales as defined by UDITPA for the following reasons:

1. Both the seller, Petitioner, and the buyer, Lockheed, are present and located in Utah by reason of their property, payroll, and sales in the state, and are deemed "within this state" for tax purposes.

2. Lockheed reported the sales, for their own tax purposes, as Utah sales.

3. The sales of the motor from Lockheed to the U.S. would be taxable as Utah sales if the U.S. were not exempt from such taxation.

4. Although Washington would and has deemed the rocket motor sales Washintgon sales, that state has not adopted UDITPA. Therefore, Petitioner cannot claim exemption from the Utah tax under the UDITPA "throwback rule." See Utah Code Ann. § 59-7-318(1)(b).

5. The Petitioner's continued duties at the Bangor facility are equivalent to warranty responsibilities and are in no way indicative of a final delivery point.

6. A Texas court held in *Bullock v. Ensearch Exploration, Inc.*, 614 S.W. 2d 215 (Tex. Civ. App. 1981), that sales of natural gas collected at a central point and then distributed, via pipeline, to out-of-state consumers were Texas sales since transactions were completed in Texas. This case is on point and should be very persuasive.

7. The phrase in the UDITPA statute "within this state," modifies "purchaser," not "delivered or shipped." This interpretation is supported by the cases cited by Petitioner as well as *Bullock*. Because Lockheed is a purchaser "within this state," the sales in question are sales justifiably figured into the "sales factor" of the UDITPA formula. See also Utah Admin. R.865-08F-1(I)(4)(a-c) (Supp. 1987).

8. Utah is not required by the Multi-State Compact or UDITPA to limit itself to the "crumbs" left after other states' taxing efforts. Utah has the right to its proportional share of tax revenues. It is the Tax Commission's responsibility to interpret and apply Utah tax law. The acts of Washington and California tax officials do not determine the taxing ability of the state of Utah.

Based on the foregoing arguments, the Respondent requests that the subject sales be considered Utah sales and included in the UDITPA "sales factor."

FINDINGS OF FACT

Based on the foregoing arguments asserted by Petitioner and Respondent and the party's pre-hearing stipulations, the Tax Commission finds the following facts:

1. The rocket motors were manufactured by Petitioner and were delivered to Lockheed, who simultaneously delivered them to the U.S. Government at Bacchus, Utah.

2. Upon transfer, the motors met contract specifications and were, for purposes of taxation, a final product.

3. Final delivery took place at Bacchus, Utah.

4. Petitioners continued responsibilities after final delivery were equivalent to warranty responsibilities and do not change or affect the point of final delivery.

5. *Bullock v. Ensearch*, Id. cited by Respondent is on point. Other cases cited by Petitioner relate to out-of-state purchasers involved in dock sales and must be distinguished factually from the case at hand.

6. Petitioner was assessed and paid Washington state "Business and Occupation" tax on all of the subject motors. However, Washington is not a UDITPA state and therefore the "throw-back rule" does not apply. See Utah Code Ann. § 59-17-318(1)(b).

CONCLUSIONS OF LAW

Under the Utah UDITPA statute, Utah Code Ann. § 59-7-317 (1987) [renumbering Utah Code Ann. § 59-13-93 (1953)], sales are in Utah if "(a) the property is delivered or shipped to a purchaser . . . within this state . . . ." Utah Admin. Rule R865-08F-1(I)(4)(b) relating to the UDITPA statute stipulates that "[p]roperty shall be deemed to be delivered or shipped to a purchaser within this state *if the recipient is located in this state*, even though the property is ordered from outside the state." Subsection (c) stipulates that "[p]roperty is delivered or shipped to a purchaser within this state *if the shipment terminates in this state, even though the property is subsequently transferred by the purchaser to another state*."

Because Lockheed is a purchaser "within this state," by virtue of its property, payroll, and sales here, and final delivery was made in Utah, the sales in question are Utah sales as determined by Utah Code Ann. § 59-7-317 (1987).

FINAL DECISION

Based on the foregoing, it is the decision of the Utah State Tax Commission that the decision of the informal hearing in favor of Respondent be affirmed.

DATED this 4th day of October, 1988.

BY ORDER OF THE STATE TAX COMMISSION OF UTAH.

/s/ R.H. Hansen
R.H. HANSEN
Chairman

/s/ Roger O. Tew
ROGER O. TEW
Commissioner

/s/ Joe B. Pacheco
JOE B. PACHECO
Commissioner

/s/ G. Blaine Davis
G. BLAINE DAVIS
Commissioner

APPENDIX E

BEFORE THE STATE TAX COMMISSION OF UTAH

Appeal No. 83 0078

HERCULES, INC.,
Petitioner,

vs.

AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,
Respondent.

FORMAL PRE-HEARING STIPULATION

The parties to the above-entitled matter, by and through their respective counsel of record, hereby stipulate and agree that the following facts are uncontroverted and will be admitted by the parties at the formal hearing of this matter scheduled for August 26, 1987:

1. The issue to be resolved in the proceeding is: Are missile motors manufactured in Utah by Hercules and sold to Lockheed under a subcontract and then sold by Lockheed to the United States under a prime contract, for use by the United States in submarines situated on the east and west coasts of the United States, "Utah sales" which may be properly included in the "sales factor" under the provisions of *Utah Code Ann.* § 59-13-93 in computing Utah Corporation Franchise Tax?

2. The additional tax claimed to be due to the Utah State Tax Commission by the auditing division for the audit period (1977-80) is the sum of $467,598.00. Of that sum, $238,882.00 is at issue in this proceeding. The Auditing Division also claims that interest is due on the

final additional tax found to be due, if any, which will run until the date of payment.

3. David R. Peirson, Manager of the State and Local Tax Department of Petitioner at Wilmington, Delaware, if called as a witness at the Formal Hearing, would testify:

a. Some of the motors here involved were shipped to the State of Washington during each of the years in the audit period. Petitioner paid Washington State "Business and Occupation" tax on all of such motors. The State of Washington concluded that "final delivery does not occur until the rocket motors are installed in Washington" as a basis for imposing this tax.

b. Some of the motors here involved were shipped to the State of California during each of the years in the audit period. The State of California treated the same as "California Sales" and they were included in the "sales factor" in computing the California Corporation Franchise Taxes for Hercules during the audit period.

4. Petitioner is taxable in each state to which motors were delivered or shipped during the audit period.

5. The rocket motors which are the subject of this proceeding were manufactured by the petitioner as a subcontractor and were sold to Lockheed as prime contractor. During the audit period Lockheed had employees stationed in Utah and did business in Utah. Lockheed, in turn, sold the same to the United States as part of the United States' defense system. During the audit period, the United States had presence in Utah and did business in Utah.

6. The rocket motors passed inspection by Lockheed and by the United States at Bacchus, Utah and title passed from Hercules to Lockheed and from Lockheed to the United States at Bacchus, Utah;

7. Petitioner had continuing contractual responsibilities for the rocket motors after passage of title to the

motors to Lockheed and to the United States at Bacchus, Utah. Such responsibilities included avoiding injury or damage to the motors and remedying product damage or defects discovered during handling, storage, assembly and installation of the motors in the rockets of which they became a part.

8. The purpose of the rocket motors which are the subject of this proceeding is to serve as the launching and delivery mechanism for military rockets finally assembled and installed in submarines at coastal cities in the United States;

DATED this 26th day of August, 1987.

/s/ Keith E. Taylor
KEITH E. TAYLOR
of and for
PARSONS, BEHLE & LATIMER
Attorney for Petitioner

/s/ Mary Beth Walz
MARY BETH WALZ
Assistant Attorney General
Attorney for Auditing Division
of the Utah State Tax
Commission

Supreme Court
FILED
NOV 12 1994
OFFICE OF THE CLERK

No. 94-644

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1994

HERCULES INCORPORATED,

Petitioner,

v.

UTAH STATE TAX COMMISSION
AUDITING DIVISION,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UTAH SUPREME COURT

BRIEF OF RESPONDENT IN OPPOSITION

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Counsel for Respondent

QUESTION PRESENTED

Does inclusion of Utah consummated sales of motors and components in the Utah sales numerator of the three-factor formula under Utah's version of the Uniform Division of Income for Tax Purposes Act constitute impermissible double taxation where the taxpayer had filed and paid taxes previously to other states?

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JURISDICTION

The judgment of the Utah Supreme Court was entered on June 10, 1994. No rehearing was sought. This Court's jurisdiction is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Utah Code Ann. §§ 59-7-317 and 318 (1987).

Utah Admin. R. 865-6-8F(I)(4)(b) and (c) (1989).

The Respondent, Utah State Tax Commission, respectfully requests that this Court deny the petition for writ of certiorari, seeking review of the Utah Supreme Court's opinion in this case. That opinion is reported at 877 P.2d 133 (Utah 1994).

STATEMENT OF THE CASE

In accordance with Rules 24.2 and 14.1(g) of the Rules of the Supreme Court of the United States, Respondent sets forth the following key facts that Petitioner misstated or omitted from its statement of the facts.

A. FACTUAL SUPPLEMENT

The following facts contained in the record below are missing from Petitioner's statement of the case:

Lockheed Missiles & Space Co. ("Lockheed"), as prime contractor, subcontracted with Hercules Incorporated ("Hercules") to furnish motors and components for a missile to be manufactured by Lockheed. (R. at 0655, 0659, 0661.)[1] There was no "Hercules-Lockheed multistate enterprise,"[2] as Hercules suggests; Lockheed was the prime contractor, Hercules was a subcontractor.

Hercules' entire manufacturing process was performed in Utah. (R. at 1103, 1150.)

The contract between Lockheed and Hercules did not require that the rocket motors be functional at the time of their delivery. (R. at 1098, 1110, 1162.)

Under the facts of this case and the terms of the contractual provisions, the missile motors and components were delivered to a purchaser, Lockheed, within the State of Utah. (R. at 1103, 1111.)

Point of delivery for Lockheed's final acceptance of the motors and components under the terms of the contract was Hercules' Bacchus, Utah facility. (R. at 0661, 1104.)

Upon final acceptance by Lockheed at Bacchus, Utah, Hercules was entitled to compensation, and payment was triggered under the terms of the contract. (R. at 1078, 1107.) Final acceptance constituted delivery for satisfying delivery schedules. (R. at 0606.)

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[1] "R." refers to the record before the Utah Supreme Court.

[2] Petitioner's Brief at p. 11.

When the motors were shipped, they were owned by the US government. Hercules acted not as shipper for itself, but as an agent for the US Navy, in shipping the motors and component parts from Bacchus, Utah to the military seaports. (R. at 0663, 1099.)

Hercules' duties in the State of Washington consisted of services in providing technical support in accordance with the terms of the contract between Hercules and Lockheed. (R. at 0669.)

In the States of Washington and California where Lockheed completed the prime contract, Hercules performed no hands-on manufacturing whatsoever on the motors and components. (R. at 1103, 1119, 1123, 1146, 1150, 1151, 1158.)

If any of the components or motors were found defective, such components and motors were returned to the State of Utah for further remanufacture and repair. (R. at 1146.)

B. UTAH'S APPLICATION OF UDITPA

For the period at issue, the State of Utah had in force the Uniform Division of Income for Tax Purposes Act ("UDITPA"). For multistate taxpayers, UDITPA provides the framework for determining how much of the taxpayer's income is subject to Utah tax. A taxpayer's total business income[3] is multiplied by an apportionment fraction to

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[3] UDITPA recognizes that a portion of a taxpayer's income might not be properly subject to apportionment. UDITPA distinguishes between "business income" which is apportioned, and "nonbusiness income" which

determine the portion that is taxable in Utah.[4] Utah's apportionment fraction is computed by averaging a property factor, a payroll factor and a sales factor, as follows:

$$\frac{\frac{\text{UTAH PROPERTY}}{\text{ALL PROPERTY}} + \frac{\text{UTAH PAYROLL}}{\text{ALL PAYROLL}} + \frac{\text{UTAH SALES}}{\text{ALL SALES}}}{3}$$

The issue in this case focuses solely on whether Utah's sales numerator should include the sales of the motors and components from Hercules to Lockheed. Under the terms of Utah Code Ann. §§ 59-7-317 and 318 (1987), (*see* attached addendum), sales of tangible personal property are included in the Utah numerator of the sales factor "if the property is delivered or shipped to a purchaser, other than the United States Government, within this State . . . ."[5] UDITPA's three-factor formula has been consistently upheld and approved by this Court. "Indeed not only has the three-factor formula met our approval, but it has become . . . a benchmark against which other apportionment formulas are

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is allocated. It is undisputed that the income from Hercules' sale of motors and components to Lockheed is part of Hercules' business income which is subject to apportionment, but it is not the only element of Hercules' apportionable income.

[4] The following illustrates the operation of the apportionment fraction:

TOTAL BUSINESS INCOME	x	UTAH'S APPORTIONMENT FRACTION	=	PORTION OF BUSINESS INCOME TAXABLE IN UTAH

[5] Formerly codified as Utah Code Ann. § 59-13-93 (1967).

judged." Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 170 (1983) (citations omitted).

Here, Utah is taxing business income apportioned to Utah; it is not taxing the separate factors of payroll, property, and sales. These factors are indicators of economic activity in Utah for purposes of determining how much of Hercules' multi-jurisdictional income is attributable to Utah. Under UDITPA, Utah applies an apportionment formula to all of the business income, not to each separate factor. Likewise, Utah's tax rate is applied to apportioned business income, not to the sales which are assigned to the numerator of the Utah sales factor.

C. DISPUTED FACTS

Respondent disputes Hercules' characterization of UDITPA and the lower court proceedings as follows:

1. UDITPA

Respondent takes exception to Hercules' characterization of UDITPA to support its allegation of "double taxation" in part 2 of its statement of the case. UDITPA apportions not only "interstate income" but all of a taxpayer's business income, wherever earned. Under UDITPA, there is no distinction between intrastate and interstate income.[6] Business income is apportioned among the states under the three-factor formula.

Second, there is no record evidence that Hercules paid tax in Washington and California on 100% of the income

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[6] *See* footnotes 3 & 4 above.

derived from the sales. The record contains no evidence of either the amount of tax paid in Washington and California or the computations supporting such payments. The inclusion of a portion of the sales of motors and components in the California sales factor numerator would increase California's apportionment fraction, but would certainly not result in 100% taxation of the income from such sales in California.

Hercules misunderstands the operation of UDITPA and mischaracterizes what is being taxed. In this case, the sales themselves are not being taxed. Rather, Utah is including the sales in its sales factor of the apportionment formula. Hercules fatally mischaracterizes such inclusion as the "taxing" of the sales.[7] It is nothing of the sort; UDITPA does not tax the individual components of the formula. Rather, the formula apportions to each state the fraction of the overall business income of the enterprise attributable to that state. This Court has held that the inclusion of an item in the income base is not tantamount to direct taxation. Shell Oil v. Iowa, 488 U.S. 19, 31 (1988). Similarly, it is fundamentally inaccurate to assert, as does Hercules, that Utah is taxing each component of net income separately. Trinova Corp. v. Michigan, 498 U.S. 358, 375 (1991); Amerada Hess v. New Jersey, 490 U.S. 66, 74 (1989).

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[7] Hercules repeatedly contends that it has been taxed on "100% of the income from those sales" (Petitioner's Brief at 4, 5) or that the "rocket motor sales were taxed twice" (Petitioner's Brief at 14). This underscores Hercules' profound misunderstanding as to the nature of UDITPA; inclusion in a factor is an indicator of economic activity in a state--it is not proof of direct taxation.

Finally, Hercules' assertion that Washington utilizes UDITPA to apportion income from sales of tangible personal property is erroneous. The State of Washington imposes a business and occupation tax, a form of gross receipts tax. It is a tax different in character from Utah's corporate franchise tax (a tax based on net income), and is not an income tax based on apportionment of income under UDITPA.[8] During the audit period, the State of Washington did not apportion any income on the basis of a three-factor formula. Washington has adopted the Multistate Tax Compact, but does not apply the multistate compact to sales involving tangible personal property under its business and occupation tax.

2. LOWER COURT PROCEEDINGS

Respondent disputes Hercules' description of the lower court proceedings and its analysis of the Utah Supreme Court's opinion. Respondent believes that the decisions below speak for themselves, but in the interest of clarity will briefly retrace them.

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[8] This Court has discussed the precise nature of the Washington business and occupation tax in two cases arising in that state. In Standard Pressed Steel Co. v. State of Washington Dep't Revenue, 419 U.S. 560 (1975), this Court noted that the business and occupation tax was "levied on the unapportioned gross receipts of appellant [Standard Pressed Steel Co.] resulting from its sale of fasteners to Boeing." Id. at 562 (emphasis added). In Tyler Pipe Industries, Inc. v. Washington Department of Revenue, 483 U.S. 232 (1987), this Court did not reach the claim that the tax system under review did not fairly apportion tax liabilities between Washington and other states, but did note that Tyler Pipe's "apportionment rests on the erroneous assumption that through the B & O tax, Washington is taxing the unitary activity of manufacturing and wholesaling." Id. at 251. This is in contrast with this case, where the issue is apportionment of the income of a unitary business.

The Utah State Tax Commission found that final delivery of the motors and components was made in Utah and, therefore, the sales were Utah sales includable in the numerator of the sales factor of the three-factor formula. The Tax Commission decision was based on the fact that Lockheed was a purchaser within the State and delivery took place in Utah, thus falling within Utah Code Ann. § 59-7-318 (1987) (UDITPA).

The district court reversed, holding that because the missiles were not completed until final delivery in the State of Washington, Utah's inclusion of the sale of motors and components in its sales factor was in violation of the Commerce Clause.

The Utah Court of Appeals reversed the district court, ruling that under the facts of the case, the sales contract between Hercules and Lockheed was for motors, not completed missiles. The motor sales were consummated in the State of Utah because final acceptance and delivery of the motors and components occurred at Hercules' Bacchus, Utah facility. The court further noted that these were Utah sales, because the sales were completed in Utah, and that these particular transactions between Hercules and Lockheed did not spill over into the States of Washington and California.

Hercules appealed to the Utah Supreme Court; it affirmed the decisions of the Court of Appeals and the Utah State Tax Commission. The court held that the Utah sales at issue were properly includable in the Utah numerator of the sales factor, as final acceptance and delivery to a purchaser within the State had occurred within Utah's borders.

Hercules misconstrues the Utah Supreme Court's language that the sales are not interstate into a broad attack on "cooperative federalism."[9] Hercules has confused the concepts of interstate sales and interstate commerce. Read in context, the court's opinion simply states that the particular transactions at issue were completed within Utah; it notes that Hercules' involvement in the manufacturing of the motors ended in Utah. This observation is not the equivalent of holding that the sales did not involve interstate commerce, as Hercules seeks to paint the decision. The court's holding that these particular transactions or sales were not extra-territorial to the State of Utah, but were fully consummated in the State of Utah, is fully supported by the record. Under the framework supplied by UDITPA, the Utah Supreme Court's conclusion that delivery had been made to a purchaser within the State justified including these sales in the Utah sales numerator.[10] The court acknowledged that the transaction between Hercules and Lockheed had occurred fully within the State of Utah and generated economic value in that State, which justified including such sales in the Utah sales numerator.

REASONS FOR DENYING THE WRIT

Hercules has not established grounds to merit review consistent with Rule 10 of this Court's rules. The decision

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[9] Petitioner's Brief at p. 7.

[10] The Utah Supreme Court stated flatly that even under a destination or market rationale, Utah was the destination or market state where the sale contemplated by the contract occurred.

of the Utah Supreme Court is not in conflict with a decision of a court of last resort in another state or of a United States court of appeals. To review Hercules' appeal on the merits would require this Court to consider issues well-settled by its prior jurisprudence. The decision of the Utah Supreme Court squares with the precedents articulated by this Court regarding taxation of multistate corporations and with decisions in this area by other state supreme courts.[11]

It would not be a beneficial use of this Court's time to revisit the factual squabble between the parties to the proceedings below. In its decision, the Utah Supreme Court construed Utah's version of UDITPA, and the result was well "within the realm of permissible judgment."[12]

No federal question or constitutional impasse has occurred which demands the intervention of this Court. The question before this Court is whether Utah's construction of its statute, which is based on a uniform act, presents a question requiring review by this Court. As this Court has

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[11] Under the "destination rule," the location of the purchaser determines the destination of the goods. Pabst Brewing Co. v. Wisconsin Dep't of Revenue, 387 N.W.2d 121, 123 (Wis. Ct. App.), *review denied*, 391 N.W.2d 209 (Wis. 1986); Department of Revenue v. Parker Banana Co., 391 So. 2d 762, 762-63 (Fla. Dist. Ct. App. 1980); Strickland v. Patcraft Mills, Inc., 302 S.E.2d 544, 544 (Ga. 1983); Olympia Brewing Co. v. Commissioner of Revenue, 326 N.W.2d 642, 644 (Minn. 1982), *contra* McDonnell Douglas v. Franchise Tax Bd, 31 Cal.Rptr2d. 712 (Cal.App.2 Dist 1994) *modified on reh.*, McDonnell Douglas v. Franchise Tax Bd., 33 Cal.Rptr.2d 129 (Cal.App.2 Dist. 1994), cert pending. Because Lockheed is a Utah company that took delivery, accepted and obtained title to the rocket motors all in Utah, Utah may properly include the sales under the "destination rule."

[12] Container Corp., 463 U.S. at 180.

already determined that UDITPA passes constitutional muster, it appears no substantial federal question exists that merits the attention of the Court.

A. HERCULES HAS NOT MET ITS BURDEN TO ESTABLISH A COMMERCE CLAUSE VIOLATION

Utah's treatment of the sales of motors and component parts fully consummated in the State of Utah, is entirely consistent with the test articulated in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).[13] Hercules concedes that the first and fourth prongs of the Complete Auto test are met; the second and third prongs are discussed below.

1. FAIR APPORTIONMENT

Regarding the second prong of Complete Auto, Hercules' naked assertion that the tax is not fairly apportioned is incorrect. To be fairly apportioned, a tax must be both internally and externally consistent. Container Corp., 463 U.S. at 169. Utah's UDITPA-based apportionment method meets both of these tests.

First, the Utah tax is internally consistent. "To be internally consistent, a tax must be structured so that if every State were to impose an identical tax, no multiple taxation

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[13] A tax should be sustained against Commerce Clause challenge if:
(1) the tax is applied to an activity with a substantial nexus with the taxing state,
(2) is fairly apportioned,
(3) does not discriminate against interstate commerce, and
(4) is fairly related to the services provided by the State.
Complete Auto, 430 U.S. at 279.

would result." Goldberg v. Sweet, 488 U.S. 252, 261 (1989). If each state included sales of goods that were manufactured, sold, and delivered to an in-state purchaser in its sales numerator, no multiple taxation would occur. Under UDITPA, the factual predicate of delivery can occur in only one state. The product of a transaction will only be delivered once to the purchaser.

Second, the Utah tax is externally consistent. In approving UDITPA's three-factor formula, this Court stated that "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." Container Corp., 463 U.S. at 169. The UDITPA three-factor apportionment formula has consistently been upheld by this Court and has become a "benchmark against which other apportionment formulas are judged." Id. at 170. Applying UDITPA, Utah's apportionment fraction reasonably reflects the fact that Hercules, through the use of property, the expenditure of payroll, and the resulting sales, generates income in Utah.

Furthermore, Hercules has failed to demonstrate that Utah's apportionment is inappropriate. This Court has stated that it will strike down the application of an apportionment formula only "if the taxpayer can prove by 'clear and cogent evidence' that the income attributed to the State is in fact out of all appropriate proportions to the business transacted in that State." Container Corp., 463 U.S. at 170 (citations omitted) (emphasis added). This Court continued, stating:

> [A]ppellant has the burden of proof; it must demonstrate that there is no rational relationship between the income attributed to the State and the intrastate values of the

> enterprise by proving that the income apportioned . . . is out of all appropriate proportion to the business transacted by the appellant in that state.

Id. at 180-81 (citations omitted) (emphasis added). Under the clear and cogent evidence standard, Hercules is required to demonstrate that the income attributed to Utah, calculated using UDITPA's three factors, is grossly disproportionate to the business activities conducted by Hercules within the state.

Hercules has failed to satisfy this burden. It is undisputed that the property and payroll factors were properly attributed to Utah. Presumably, to the extent Hercules had payroll and property in California, they were reflected in the payroll and property factors in that state.[14] UDITPA does not, as Hercules suggests, arbitrarily assign factors among the various states in order to achieve some theoretical balance. Rather, it apportions income given the facts and circumstances as a whole.

Under Utah's UDITPA provisions, these sales are appropriately included in the sales numerator by the State of Utah. In this case, the delivery of the rocket motors was found by the Utah Tax Commission, the Utah Court of Appeals, and the Utah Supreme Court to have occurred at Bacchus, Utah. Hercules has not shown that this finding is clearly erroneous. Hercules has also failed to demonstrate that the income attributed to Utah did not have a substantial relationship to the State of Utah.

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[14] As noted previously, Washington does not employ UDITPA to apportion income based on these factors. *See* footnote 8 above.

2. FAILURE TO SHOW DISCRIMINATION

The third prong the Complete Auto test is met as the Utah tax does not discriminate against interstate commerce and is consistent with this Court's interstate commerce cases and with UDITPA.[15] No discrimination, facial or as applied, has been proven in this case. Here, discrimination is claimed solely on the basis of alleged duplicative taxation. Simply put, there is insufficient evidence for this proposition.

In fact, the record contains no evidence whatsoever as to the income tax implications in this case. No computations or figures were introduced to show the amount of income attributed to California or the amount of tax actually paid in California. No computations or figures were introduced to show the impact on California's apportionment fraction if sales of motors and components were included in California's sales numerator. There is a similar lack of proof with regard to Washington business and occupation tax, which is not even a tax based on apportionment of income. Consequently, the record does not support a contention that more than 100% of Hercules' income was being subjected to state taxation, or suggest that the amount of Hercules' income being taxed in Utah was not fairly representative of Hercules' business activities in Utah. Hercules bases its whole case on its bald assertion that because the sales at issue were included in the factors of more than one state,

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[15] Goldberg, 488 U.S. at 265-66; Container Corp., 463 U.S. at 170-171, 180-85; Exxon Corp. v. Wisconsin Dep't of Revenue, 447 U.S. 207, 228-30 (1980); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 443-46 (1980); and Moorman Mfg. Co. v. Bair, 437 U.S. 267, 277-80 (1978).

duplicative taxation exists. No evidence exists in the record to support such a claim.

In Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978), this Court refused to find double taxation in a taxpayer challenge of apportionment based upon a single sales factor, noting, "[s]ince there is no evidence in the record regarding the percentages of total net income taxed in the other States in which it did business during those years, any claim that appellant was taxed on more than 100% of its total net income would also be speculative." Id. at 276-77 n.11. Similarly, Hercules presented no evidence regarding the net income attributed to California or the resulting income tax paid.[16] Hercules has not demonstrated that it was taxed on more than 100% of its total net income. It has simply asserted double inclusion of the same sales in one of the three apportionment factors. The inclusion by more than one state of sales in the sales factor is not the equivalent of multiple taxation.

An overlap in including sales in the sales factor numerator of two taxing states is not proof of multiple taxation. Moorman specifically rejects the rationale espoused by Hercules in refusing to construe the Commerce Clause as prohibiting "any overlap in the computation of taxable income by the States." Id. at 278.

It should be noted that Hercules has not indicated the cause for attributing the sales at issue to California and Washington. There is no suggestion that the conflict over the sales did not occur as a result of Hercules' own voluntary

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[16] Washington's business and occupation tax applies to gross receipts, not net gross income.

self-assessments. Thus, nothing in the record suggests that Hercules was audited in the States of Washington or California, nor that taxing entities in those states made any changes whatsoever to Hercules' self assessment as reflected in its returns. No adjudicative decisions from those states are in the record to establish that the assignment of sales was even disputed in those states. Contrary to Hercules' assertion that Respondent stipulated to the fact of double taxation, the Auditing Division merely stipulated that Hercules' tax manager would testify that the sales at issue had been included in California's sales factor and that it had paid Washington business and occupation tax on the sale of the motors.[17]

Hercules' self-assignment to the other states of the sales Utah disputed in its audit does not make Hercules' case. First, Hercules made no showing that the other states would have required such an assignment of the sales if aware of the facts in the case. Second, there was no showing of what happened with respect to the payroll and property factors in California. Third, no showing was made of the overall income picture, i.e. other sources of income and activities in the relevant states. Fourth, even if overlap exists, it is constitutionally permissible. UDITPA simply requires approximation.

It is not the judicial role of this Court to act as the uniformity police to assure that states administer apportionment factors uniformly. Moorman, 437 U.S. at 279. The taxpayer has simply not met its burden of

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[17] R. at 0656.

demonstrating that the Utah imposed tax was in any way unfair or disproportionate to the company's activity in Utah.

B. THE FACTUAL RECORD UPON WHICH THE UTAH SUPREME COURT MADE ITS STATE LAW DETERMINATION DOES NOT SUPPORT HERCULES' CONSTITUTIONAL CLAIM

The central issue before the Utah Supreme Court was and still remains: Were these sales properly includable under Utah law in the Utah sales numerator based on the facts of the case? The decision of the Utah Supreme Court was based upon a careful examination of the factual record before it, including witnesses, exhibits, and demonstrative evidence. The court correctly applied the applicable UDITPA provisions governing the apportionment of income.

The Petitioner urges that UDITPA be examined as a theoretical construct and that this case be considered in a vacuum. For "[f]acts are stubborn things; and whatever may be our wishes, our inclinations, or the dictates of our passions, they cannot alter the state of facts and evidence."[18]

In Hercules' entire brief, little mention is made of the fact that Utah is the site for delivery, final acceptance, and passage of title from Hercules to Lockheed and for passage of title from Lockheed to the US government. Such acceptance constituted delivery for satisfying the delivery schedules and provided substantiation for billing purposes. Hercules' involvement in the hands-on manufacturing process

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[18] John Adams (1735-1826), Lawyer and Second President of the United States.

was completed entirely in the State of Utah, and Hercules never again touched these motors and components as they were fashioned by Lockheed into the missiles sold to the US Navy.

In examining the facts of this case, as the Utah Supreme Court did to make its state law determination, the true relationship between Hercules and Lockheed cannot be overemphasized. Hercules was one of a number of subcontractors; Lockheed was the prime contractor. Hercules was responsible to deliver motors and components to Lockheed; Lockheed was responsible for the delivery of completed missiles to the US government. Hercules was in privity of contract with Lockheed; Lockheed enjoyed privity of contract with the US government. Final acceptance of the motors and components, which are at issue in this case, took place at Bacchus, Utah when Lockheed took delivery from Hercules; final acceptance of the completed missile system took place in the State of Washington in fulfillment of the Lockheed-US Government contract. Hercules provided no further hands-on involvement once the motors and components left the State of Utah, but merely provided technical assistance in accordance with the terms of the contract; Lockheed had hands-on manufacturing obligations in assembling the missiles in the seaport states. If any of the motors or components were defective, they were returned to the State of Utah.

C. THE PUBLIC POLICY AGAINST TAX FORUM SHOPPING SUPPORTS RESPONDENT'S POSITION

Hercules overstates the relevance of the proffered testimony of its tax manager regarding treatment of the sales

in California and Washington, arguing that Utah should now be barred from including these sales in its sales numerator. If such logic were to be adopted, multi-state taxation would be reduced to forum shopping for a state with lower marginal tax rates and generous exemptions. The taxpayer would then rush to pay the tax in such a taxing jurisdiction. The absurdity of such a position is readily evident - - - facts, not desires, must control the apportionment process.

CONCLUSION

Hercules failed to meet its burden of proof to establish duplicative taxation violative of the Commerce Clause. The factual findings in this case clearly support Utah's inclusion of the sales of the motors and components in the Utah sales numerator, and reflect a fair apportionment of Hercules' business income for the tax years in question. Thus, the petition for certiorari should be denied.

Respectfully submitted,

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ADDENDUM

Utah Code Ann. § 59-7-317 (1987)

Sales factor for apportionment of business income.

> The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

Utah Code Ann. § 59-7-318 (1987)

Sales of tangible personal property.

(1) Sales of tangible personal property are in this state if:

> (a) the property is delivered or shipped to a purchaser, other than the United States Government, within this state, regardless of the f.o.b. point or other conditions of the sales; or
>
> (b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state, and:
>
> (i) the purchaser is the United States Government; or
>
> (ii) the taxpayer is not taxable in the state of the purchaser.

(2) Sales of tangible personal property are not in this state if the seller and the purchaser would be members of the same unitary business group but for the fact that either the seller or the purchaser is a foreign operating company, and the property is purchased for retail outside the United States.

Utah Admin. R. 865-6-8F(I)(4)(b) and (c)

(b) Property shall be deemed to be delivered or shipped to a purchaser within this state if the recipient is located in this state, even though the property is ordered from outside this state.

(c) Property is delivered or shipped to a purchaser within this state if the shipment terminates in this state, even though the property is subsequently transferred by the purchaser to another state.

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No. 94-644

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HERCULES INCORPORATED,
Petitioner,

v.

UTAH STATE TAX COMMISSION
AUDITING DIVISION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of the State of Utah

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REPLY BRIEF OF PETITIONER

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STATUTE

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REPLY BRIEF OF PETITIONER

In the petition for a writ of certiorari, petitioner Hercules Incorporated demonstrated that (1) the decision of the Utah Supreme Court below permitted Utah to excise a double tax on the income generated by the interstate sale of Trident missile motors in direct conflict with this Court's Commerce Clause precedents, and (2) *only* this Court can resolve this controversy generated by the taxation of the same income by more than one state.

Respondent disingenuously seeks to disguise the constitutional infirmity inextricably imbedded in the foundation of the Utah Supreme Court's decision in this case. Indeed,

respondent does not even mention, much less discuss or analyze, petitioner's principal case from this Court addressing the problem of unfairly apportioned tax assessments, *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123 (1931). Instead, respondent attempts to bury the Commerce Clause issue in this case in a morass of alleged "factual squabble[s]" (Opp. 10) in hopes that the Court will decline to review the decision of the court below. But the decision below—permitting Utah to apply its income tax to the entire value of the interstate sales at issue here—presents a pure question of law both suitable for review and warranting review by this Court.

1. After several years of litigation over the disputed tax in this case, respondent for the first time asserts that "the record contains no evidence whatsoever as to the income tax implications in this case" (Opp. 14) and attempts to turn a blind eye to its own pre-hearing stipulation, reproduced at Pet. App. 34a-36a. Contrary to respondent's assertion, the record clearly establishes that double taxation of petitioner's income resulted from Utah's decision to tax 100% of the income generated by the Trident missile motor sales.

First, petitioner does not have a "profound misunderstanding" (Opp. 6 n.7) of how income is allocated under UDIPTA for state income taxation, nor did it "mischaracterize" (*id.* at 6) what is subject to taxation. As petitioner previously explained (Pet. 4), income, and not sales, are taxed under UDIPTA. This is clear even from the citations to the petition contained in respondent's brief. See Opp. 6 n.7 ("Hercules repeatedly contends that it has been taxed on '100% *of the income* from those sales' ") (quoting Pet. 4-5) (emphasis added). Respondent has made the only "fatal[] mischaracteriz[ation]" (*id.* at 6) in this case. Petitioner has focused on the sales factor of the income tax allocation formula because it is the income generated by the rocket motor sales that has been subjected to double taxation. *Cf.* Brief of Utah State Tax Comm'n in the Utah S. Ct. at 4 ("The issues in this case pertain only to the sales factor of the formula").

Respondent cannot deny that it *is* taxing *income* when it inputs figures into the in-state numerator of UDIPTA's three-factor formula. Additions to the sales numerator have a direct and proportional effect on income apportionment. Respondent is attempting to play a shell game with the three-factor formula when it suggests that the income generated by the rocket motor sales was not "direct[ly]" taxed. Opp. 6. If respondent's characterization is accepted, apportionment formulas could never be reviewed for conformity with the Commerce Clause. This Court's decision in *Shell Oil Co.* v. *Iowa Department of Revenue,* 488 U.S. 19, 31 (1988), cited by respondent (Opp. 6), did hold that "the inclusion of income in the *preapportioned tax base* of a state apportionment formula does not amount to extraterritorial taxation." *Shell Oil,* 488 U.S. at 30-31 (emphasis added). However, the preapportioned tax base involves the *denominators* in the three-factor formula. *Id.* at 22 nn. 3-4. As this Court recognized in *Shell Oil,* income from sales included in the in-state *numerator* is directly taxed. *Id.* at 31 (sales at issue "not taxed directly by any State because they are not included in the numerator of the sales ratio").

Second, notwithstanding respondent's current denial (Opp. 16), Utah stipulated and agreed that it was "uncontroverted" (Pet. App. 34a) that California included the sales of all rocket motors shipped to California in the in-state numerator of its three-factor formula. *Id.* at 35a. Therefore, both California and Utah directly taxed all the income generated by these rocket motor sales. Not only is double taxation clear on the record before this Court, it is clear that 100% of the income generated by the rocket motor sales was taxed in each jurisdiction.

Likewise, it was stipulated and agreed that petitioner paid Washington tax on all motors shipped to Washington on the basis that Washington considered delivery of the motors to have occurred there. *Id.* at 35a. Washington has adopted the Multistate Compact's UDIPTA. See Wash. Rev. Code § 82.56.010. Whatever may be said about the character of Washington's Business and Occupa-

tion Tax,* and whether UDIPTA's three-factor formula was applied by Washington to determine petitioner's tax burden, it is clear from the record that Washington taxed the rocket motor sales, and that it only taxed those sales that it apportioned to the state. Irrespective of their labels, both state taxes assessed were taxes on the income generated by the rocket motor sales. Furthermore, the issue of double taxation is squarely raised by this case if *either* California or Washington had already taxed the income generated by the rocket motor sales subsequently taxed by Utah.

2. Not only is the record concerning double taxation clear, the interstate nature of the transactions taxed by Utah is readily apparent. Respondent claims that "Hercules has confused the concepts of interstate sales and interstate commerce." Opp. 9. Faced with the undeniable interstate nature of the missile transaction and the federal interests at stake in this dispute (see Pet. 7), respondent attempts to distinguish between interstate sales and intrastate sales that "involve interstate commerce" (see Opp. 9). This argument is another transparent ruse by Utah to evade its obligations under the Commerce Clause. The simple fact of the matter is that the Utah Supreme Court determined that the Commerce Clause was not violated because the sales were "transactions occurring solely within this state." Pet. App. 9a. The Utah Supreme Court made no distinction between "sales" and "commerce." Moreover, no such distinction is plausible if the allocation of income between the various states is to be governed by constitutional standards rather than artificial labels concocted by states attempting to maximize revenues. Despite the passing of legal title in Utah, petitioner performed substantial activity at the seaport sites in Califor-

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* In *Deseret Pharmaceutical Co.* v. *State Tax Commission*, 579 P.2d 1322 (Utah 1978), the Utah Supreme Court upheld respondent's use of UDIPTA's income tax allocation provisions to apportion a taxpayer's income as represented by Washington's Business and Occupation tax.

nia and Washington where it interfaced the motor components and supervised the assembly of the motors into the completed Trident missiles, all before the missiles were physically delivered to the United States Navy. Pet. 3. The sales of the rocket motors were part and parcel of an enterprise that did not end at Utah's borders.

3. This case is not similar to *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267 (1978), where the claim of double taxation was speculative. In *Moorman*, the taxpayer had not shown what portion of the sales in question had been taxed by the two jurisdictions. *Id.* at 276. Here, the record is clear that 100% of the income generated by the rocket motor sales was taxed in two separate states. While the Court in *Moorman* found that the Commerce Clause did not require perfect precision or prohibit "any overlap" in the apportionment of income tax among the states, *id.* at 278, the overlap in this case is more than *de minimis*, it is *total*. As such, this Court's holding in *Hans Rees' Sons, Inc.* v. *North Carolina*, 283 U.S. 123 (1931), a decision not even addressed by respondent, provides the governing framework for this case. Utah's taxation of *100%* of the interstate commerce resulting in the rocket motor sales is "out of all appropriate proportion" and therefore violates the Commerce Clause. *Id.* at 135.

4. The decision by the Utah Supreme Court below and respondent's arguments in opposition to the petition are primarily an attempt to demonstrate that Utah appropriately considered the rocket motor transactions intrastate sales for purposes of determining income taxes. Even if these arguments were convincing, however, they still would not negate petitioner's second reason for urging this Court's review. Only this Court can resolve the controversy surrounding the taxation of the same income by more than one state. Because more than one state claims the right to tax the income generated by the rocket motor sales, this Court's guidance is necessary so that petitioner, and all other members of industry and com-

merce operating across state lines, can pay fairly apportioned taxes to the appropriate jurisdiction. Nothing in the record suggests that petitioner went "forum shopping" (Opp. 19) in an attempt to reduce its tax burden. Instead, petitioner paid income taxes to both of the states where its rocket motors were destined pursuant to the then-uniform interpretation of UDIPTA. Utah did not protest until five years later. The injustice addressed by the Commerce Clause is an individual state's attempt to burden interstate commerce unreasonably. Accordingly, the decision of the Utah Supreme Court disregarding the constitutional restraints of the Commerce Clause merits this Court's review.

CONCLUSION

For the foregoing reasons, and those stated in the petition, the petition for a writ of certiorari should be granted.

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